



EU and G20
TRANSFER PRICING
HANDBOOK



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EU AND G20: TRANSFER PRICING HANDBOOK

Transfer pricing – Changing the tax landscape for related party dealings

DFK International is proud to release the updated DFK Transfer Pricing Handbook.

It is impossible to overstate the importance of transfer pricing in the current global business environment.

Cross border tax issues were once problems for only the largest and most sophisticated multinational corporations. Today, an ever-growing portion of the economy operates in a borderless environment that facilitates cross border trade and investment. Middle market and privately held businesses can be just as exposed to transfer pricing issues as the Fortune 500. A decade ago, many governments had not enacted transfer pricing legislation. Today, almost every major economy has such legislation. Previously, tax authorities did not have the knowledge or resources to challenge taxpayers in relation to transfer pricing matters. Today, those tax authorities have built departments with deep expertise that aggressively pursue taxpayers. More and more governments and tax authorities view transfer pricing as an easy revenue raiser.

All taxpayers who engage in transactions with related parties need to understand what transfer pricing is, when it may affect them, and options for how to defend themselves against taxing authorities.

In the three years since issuing the first edition of this handbook, there have been significant evolutions in the development of transfer pricing principles, documentation standards, and intergovernmental information sharing and coordination. Many countries have issued new rules and regulations. There have been some important court decisions, some in favor of taxpayers, some in favor of the tax authorities. The OECD's *Base Erosion and Profits Shifting project* ("BEPS") has introduced a range of new concepts, including country-by-country reporting and how the economic ownership of intangible property should be determined. It has arguably changed how some view the "arm's length" standard, the foundation for most transfer pricing regimes. These changes are being widely adopted among the OECD members and beyond. At the same time, not every country is adopting every OECD recommendation, and many countries are adopting inconsistent interpretations of these rules.

In such an evolving environment, this updated handbook, which provides a summary of the rules for over 30 different transfer pricing regimes around the world, can act as an excellent reference and guide.

I encourage you to review the transfer pricing summaries within this handbook and reach out to your local DFK advisor to discuss the transfer pricing risks and opportunities facing your business. Through its worldwide team of experts, DFK can advise you and assist you to optimise your transfer pricing position and meet all your transfer pricing documentation needs.

January 2018

Ryan Dudley

Chairman

DFK International Tax Committee

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GLOSSARY

The following table provides definitions of common terms used throughout this handbook.

| Term | Definition/description |
|------------------------|---|
| Adjustments | <p>When material differences between the tested party and the comparable companies that would affect the comparability of profits exist, adjustments should be performed to account for those differences. Most common adjustments are Accounting Adjustments and Capital Adjustments.</p> <ul style="list-style-type: none"> • Accounting Adjustments include inventory valuation method adjustment, reporting of intangibles adjustment, and employment benefits adjustment. • Capital Adjustments include accounts receivable adjustment, inventory adjustment, and accounts payable adjustment. |
| AOA | Authorised OECD Approach – the approach for attributing profits to permanent establishments. |
| APA | Advance Pricing Agreement – an agreement between a taxpayer and tax authority on the appropriate transfer pricing methodology made in advance and lasts for a set period of time. |
| Arm's Length Principle | The international standard that most countries have agreed should be used for determining transfer prices for tax purposes. It 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 independent enterprises, then any profits which would, but for those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.” |
| BEPS | Base Erosion and Profit Shifting – refers to tax avoidance strategies taken by taxpayers to exploit gaps and mismatches in tax rules between jurisdictions to artificially shift profits to low or no-tax locations. |
| BEPS Actions | Refers to the 15 Actions published by the BEPS project. Most relevant Actions to TP are Actions 8, 9, 10, & 13. |
| BEPS Action 13 | <p>The BEPS Action relevant to transfer pricing documentation. Specifically:</p> <ul style="list-style-type: none"> • CbCR (<i>Country-by-Country Report</i>) – Contains information relating to the global allocation of the MNE group's income and taxes paid together with certain indicators of the location of economic activity within the MNE group. • Local File – Contains specific material transactions of a local taxpayer. • Master File – Contains standardized information to all MNE group members. |

| Term | Definition/description |
|--|--|
| BEPS Project | An OECD and G20 initiative containing a 15-Action package that equips governments with the domestic and international instruments needed to tackle BEPS. |
| Burden of Proof | Shifted from the taxpayer to the tax administration when transfer pricing documentation is in place (this is considered a major advantage to having transfer pricing documentation in place). |
| CA | Competent Authority – the authority which represents the local tax authority in dispute resolution cases (under mutual agreement procedures). |
| Comparables/ Comparable Companies | Companies used in an analysis to determine the arm's length range of pricing an intercompany transaction. Usually, these companies have similar functions, risks, and assets as the tested party. |
| CIT | Corporate Income Tax |
| Contracting State | Refers to the foreign country with which a local country has a Tax Treaty. |
| Controlled Transaction | A transaction that occurs between two or more related parties (as defined by each jurisdiction). |
| EU JTP Forum | European Union Joint Transfer Pricing Forum |
| EU TPD | The Code of Conduct on Transfer Pricing Documentation for Associated Enterprises in the European Union – common approach to transfer pricing documentation requirements throughout the EU. |
| Interquartile Range | Provides the most probable and representative range of results, eliminates extreme points that may skew the data, and indicates the most typical values of the data. <ul style="list-style-type: none"> • Lower Quartile – the value below which 25% of results lie. • Median – the value below and above which 50% of results lie. • Upper Quartile – the value above which 25% of results lie. |
| MAP | Mutual Agreement Procedure. |
| MLI | Multilateral Instrument – drafted at the Multilateral Convention to implement Tax Treaty-related measures to prevent BEPS. |
| MNE | Multinational Enterprise |
| Model Treaty | The OECD's Model Tax Convention |
| Multi-Year Averages | To mitigate for single-year fluctuation relating to business cycle, the use of multi-year data is prescribed by most countries. Usually, the three most recent years for which financial information is available are used and averaged to create the “three-year range of results” to which the tested party's results are compared. (specific deviations will be indicated in each specific country's page). |

| Term | Definition/description |
|----------------------------|---|
| OECD Guidelines | The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Adopted by most countries (specific deviations will be indicated in each specific country's page). |
| PE | Permanent Establishment |
| Penalty Protection | Some countries provide penalty protection for taxpayers who document intercompany transactions in a contemporaneous manner (i.e., on a yearly basis). |
| PLI | Profit Level Indicator |
| SME/SMEs | Small and Medium Sized Enterprise(s) |
| TA/TAs | Tax Authority/Tax Authorities/Tax Administration |
| Tax Treaty(ies)/DTT | Double Tax Treaty or Convention |
| TP | Transfer Pricing |
| TPD | Transfer Pricing Documentation |
| TP Methods | <p>Commonly accepted methods for analysing intercompany transactions. The OECD Guidelines specify:</p> <p>Traditional Transaction Methods:</p> <ul style="list-style-type: none"> • Comparable Uncontrolled Price ("CUP") Method • Resale Price Method ("RPM") • Cost Plus Method <p>Traditional transaction methods are considered the most direct mean to establish arm's length comparability because the arm's length conditions can be established by substituting the price in the uncontrolled transactions with that in the controlled transaction. In other words, these methods verify the comparability of the transaction rather than the price.</p> <p>Transactional Profit Methods:</p> <ul style="list-style-type: none"> • Transactional Net Margin Method ("TNMM") • Profit Split Method ("PSM") <p>Considered appropriate in situations such as:</p> <ol style="list-style-type: none"> 1. When public information about unrelated parties is not available at the level necessary to determine comparability (i.e., no internal comparables). 2. Cases that involve valuable and unique contributions by both parties. 3. When Both parties engage in highly integrated activities. <p>Most tax administrations that adopt the OECD Guidelines also adopt the above methods (specific deviations will be indicated in each specific country's page).</p> |

LEGEND

The following provides definitions of terms and an overview of the topics covered in this handbook.

Statutory rules/laws

Provides information regarding the local tax laws, rules, or regulations currently in effect.

Definition of related party

Describes what the local TA considers a related party for TP purposes.

Treatment of the OECD Guidelines

Explains how the local TA treats the OECD Guidelines in implementing the relevant laws, rules, or regulations. (i.e., are OECD Guidelines adopted or not, what are the differences between local laws and the OECD Guidelines, if any, etc.).

Accepted TP methods and priority

Lists the local TA's accepted TP methods a taxpayer may use when analysing intercompany transactions and the local TA's preferred priority in which methods should be evaluated and selected, if any.

Documentation requirements

Provides an overview of the requirements and recommendations provided by the local TA regarding the documentation of a taxpayer's intercompany transactions.

Tax audit procedure

Provides an overview of the local TA's TP audit procedure.

Income adjustment, surcharges, and penalties

Describes the consequences of local TA's rejection of taxpayer's TP policy and the applicable surcharges and penalties thereof.

Advance pricing agreement

Explains whether the local TA offers the taxpayer the option to enter an APA.

Ex post measures to prevent double taxation

Provides details regarding the local TA's options offered to a taxpayer for solving double-taxation issues.

Intercompany financing

Describes the way the local TA treats intercompany financing transactions.

Safe harbour provisions/exemptions for SMEs

Describes any provisions/exemptions allowed for SMEs in each jurisdiction.

TP and PEs (AOA)

Explains the link or lack thereof to AOA for attributing profits to PE.

Other topics

Provides country-specific issues/topics that are not covered by the above topics, if applicable.

Contact information

Provides local contact information for assistance with TP issues.

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TABLE OF CONTENTS: COUNTRY SPECIFIC ISSUES

| | |
|----------------|-----|
| Argentina | 8 |
| Australia | 11 |
| Austria | 22 |
| Brazil | 29 |
| Canada | 34 |
| China | 42 |
| Croatia | 48 |
| Cyprus | 53 |
| Czech Republic | 56 |
| France | 60 |
| Germany | 64 |
| Greece | 72 |
| Hungary | 77 |
| India | 83 |
| Indonesia | 91 |
| Ireland | 96 |
| Israel | 103 |
| Italy | 107 |
| Japan | 115 |
| Mexico | 122 |
| Netherlands | 127 |
| New Zealand | 132 |
| Poland | 137 |
| Portugal | 140 |
| Russia | 147 |
| Serbia | 152 |
| Singapore | 156 |
| Slovakia | 161 |
| Slovenia | 165 |
| South Africa | 169 |
| South Korea | 173 |
| Spain | 177 |
| Sweden | 183 |
| Switzerland | 190 |
| United Kingdom | 193 |
| United States | 199 |

Argentina



Statutory rules/laws

- Income Tax Act (Ley del impuesto a las ganancias), art. 8 to 15
- Resolución General of the Administración Federal de Ingresos Públicos (“R.G. AFIP”) 1122
- Referred to as the “AR TP Regulations”

Definition of related party

R.G. AFIP 1122 Annex III provides a comprehensive guide of cases of related parties. For example, directly or indirectly control of another entity by owning the majority of capital or votes, board of directors in common, special contractual agreements, exclusivity as distributor or selling agent, etc.

Treatment of the OECD Guidelines

The AFIP considers AR TP legislation to be consistent with the OECD Guidelines. However, the OECD Guidelines should not be relied upon to support cross border TP positions from AR income tax perspective or in domestic applications. The OECD Guidelines may be used to demonstrate compliance with international principles.

Accepted TP methods and priority

Income Tax Act adopts the methods prescribed by the OECD Guidelines. Additionally, a sixth method may be applied to value transactions of commodities when the foreign party is not the same as the addressee of the goods. In that case, the method consists in valuing the transaction using the price of the commodity in international markets at the day of the transaction.

Documentation requirements

a. Filing deadline

Some forms must be submitted to AFIP during the 11th month of the fiscal year, and some forms must be submitted during the sixth and seventh months after the closing of the fiscal year.

Additionally, during the eighth month after the closing of the fiscal year, a package must be electronically filed, containing the following:

- form F 743;
- an analysis with the description of the operation under scope, details of transactions between related parties, methods applied and discarded, functions and assets employed; and
- an independent accountant's report.

b. Mandatory language

The report must be prepared in Spanish. If it includes documentation in foreign language, it must also be translated into Spanish.

c. Alignment with new Ch. V of OECD Guidelines/BEPS Action 13

As Argentina is in the process of applying to a membership to the OECD, AFIP has recently ruled that every international group with sales of more than USD 750 million must designate the (or one of the) local party to submit information related to the financial situation and TP agreements of the company; or if one of the companies of the group is obliged to file this report in its own country, that situation must be reported to AFIP.

Tax audit procedure

There is no specific procedure set by AFIP to TP audits. However, all the supporting documentation used by the taxpayer to prepare the annual report must be saved properly for the prescription time (6 years approximately) and can be required by AFIP at any time.

Income adjustment, surcharges, and penalties

A transaction that is not considered to have been conducted at arm's length must be revalued and the adjustment to the interquartile range (generally the median) is considered an adjustment to the taxable income of the local party.

A variety of consequences could arise from not submitting the annual package. A penalty starting at ARS 20,000 and up to ARS 450,000 could be applied for not filing on time or not submitting the supporting documentation to AFIP on time.

Advance pricing agreements

APAs are not permitted per our rules.

Ex post measures to prevent double taxation

There are not measures to prevent double taxation derived from TP adjustments. Argentina has not signed onto the MLI, either.

Intercompany financing

AR TP Regulations do not set forth specific methods to value loan transactions. However, article 18 of Income Tax Act sets a condition on deduction of interests (and in general, services). The condition is that the interests or services owed to a foreign related party must be paid before the end of fiscal year or at tax return due date.

Safe harbour provisions/exemptions for SMEs

There is a certain limitation in the deduction of expenses when the foreign party is established in a non cooperating country. No exemptions are admitted for SMEs. TP presentation must be submitted in every case there is a foreign party that fits the definition of related party, no matter the amount of the transaction.

TP and PEs (AOA)

There are no specific provisions in Argentinian legislation related to TP and PEs rather than the general provisions applicable to all taxpayers, regardless if they are subsidiaries, local companies, branches, or any other kind of PE.

Contact information

For more information and TP related issues in Argentina, please contact:

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Australia



Statutory rules/laws

a. Legislation

- Subdivisions 815-A to E of the Income Tax Assessment Act 1997 (“ITAA 1997”) and Subdivision 284-E of the Taxation Administration Act 1953 (“TAA”); and
- Australia’s double tax agreements (“DTAs”) are also relevant –Specifically Article 9.

b. Taxation Rulings and the Australian Tax Office (“ATO”) Practice Statements

- Taxation Rulings TR 2014/6 and, TR 2014/8; and
- Practice Statement Law Administration PS LA 2014/2, PS LA 2014/3, and PS LA 2015/4.

Definition of related party

The term is not defined in the domestic law but is referenced to in most of Australia’s international tax agreements (under Article 9), which is taken from the Model Treaty. The definition of Associated Entity in the OECD Guidelines is also referenced to Article 9.

Broadly speaking, Australia’s TP rules apply to transactions or dealings with international related parties, which are parties are persons who are not dealing wholly independently with one another in their international commercial or financial relations. The term includes:

- Any overseas entity or person who participates directly or indirectly in the company’s management, control, or capital;
- Any overseas entity or person in which the company participates directly or indirectly in the management, control, or capital; and
- Any overseas entity or person in which persons who participate directly or indirectly in its management, control, or capital are the same persons who participate directly or indirectly in the company’s management, control, or capital.

Treatment of the OECD Guidelines

The ATO fully endorses the OECD Guidelines, and the concepts contained in the current law are largely taken from these guidelines.

Australia has been an active participant in the global BEPS movement and has introduced new laws which adopt a process that should be undertaken in determining TP outcomes.

The main changes that the new legislation brings are: self-assessment, a strict approach to documentation, and the need to consider the hypothetical reconstruction of the commercial and financial relationships for the purpose of determining the tax liability.

In applying Subdivisions 815-B to E to a matter, a taxpayer and the ATO must apply the law so as to best achieve consistency with the OECD Guidelines.

Accepted TP methods and priority

Australia's TP rules do not prescribe any particular methodology or preference for the order in which methodologies might be applied to arrive at an arm's length outcome. All methods outlined in the OECD Guidelines are acceptable.

The statutory objective should be interpreted as allowing the greatest possible scope to use methodologies appropriate in the circumstances, given the myriad of different and possibly unique cases that may arise.

- The ATO recommend that the method used should be best suited to the circumstances of each case and whatever method is used should give the most commercially realistic outcome in the circumstances.

The CUP or Cost Plus methods are the preferred methods as they provide the most reliable comparables where data and information within Australia is readily available.

Documentation requirements

Documentation must be prepared to meet the requirements set out in Subdivision 284-E of the TAA 1953 to ensure a taxpayer has a Reasonably Arguable Position ("RAP").

ATO ruling TR 2014/8 provides further guidance on the ATO's views on documentation to be maintained.

The documentation needs to be more than an economic analysis and must include a comparison of the arm's length conditions and profits/losses and the actual conditions and profits/losses in order to determine where there is a TP benefit. The identification of the arm's length conditions must:

- be based on the commercial or financial relations in connection with which the actual conditions operate; and
- have regard to both the form and substance of those relations.

The documentation must also explain how, in identifying arm's length conditions, the taxpayer has achieved consistency with prescribed guidance material comprising the OECD Guidelines and other material prescribed in the domestic law and needs to be prepared at the time that the taxpayer lodges their income tax return. Any departure from the prescribed guidance material needs to be explained.

Australia's TP rules contain a reconstruction principal. Documentation must consider the potential use of reconstruction in order to conclude that section 815-130 has been properly addressed and the arm's length conditions have been determined based on the correct commercial and financial relations.

The conditions that operate on a reconstructed basis include, but are not limited to, such things as price, gross margin, net profit, and the division of profit between the entities.

Australia's TP compliance operates on a self-assessment basis. Public officers and tax agents that sign off on the tax returns are making a statement that the laws in relation to TP have been correctly applied to determine the taxable income of an entity. A thorough risk assessment is required, including applying a level of certainty in relation to each matter having regard to materiality and the likelihood of challenge.

There is no statutory requirement for a taxpayer to maintain TPD. However, the ATO expects a taxpayer to be able to support the prices used in its associated party cross-border transactions. Preparing TPD provides support for the taxpayer's pricing position and shifts the burden of proof to the ATO to prove that the prices used are not arm's length.

There are five key questions for a taxpayer to consider when documenting its TP treatment:

1. What are the actual conditions that are relevant to the matter (or matters)?
2. What are the comparable circumstances relevant to identifying the arm's length conditions?
3. What are the particulars of the methods used to identify the arm's length conditions?
4. What are the arm's length conditions and is/was the TP treatment appropriate?
5. Have any material changes and updates been identified and documented?

The ATO recommends that a taxpayer considers all five questions (not necessarily sequentially) in light of its own facts and circumstances, including the relative complexity and materiality of its relevant dealings and its self-assessed risk.

The process is broadly similar to the process outlined in the new Ch. V of OECD Guidelines and in BEPS Action 13, which has been legislated in Subdivision 815-E of ITAA 1997.

Taxpayers who are classified as 'significant global entities' (i.e., with a global turnover of over AUD 1 billion) are required to provide certain statements to the ATO (corresponding to BEPS Action 13 Annexes I, II, & III).

The statements are made up of the following:

- a. a Master File comprising a statement relating to the global operations and activities, and the pricing policies relevant to transfer pricing, of:
 - i. the taxpayer; and
 - ii. if the taxpayer was a significant global entity during the preceding income year by virtue of their membership of a group of entities – the other members of that group;
- b. a Local File comprising a statement relating to the taxpayer's operations, activities, dealings and transactions;
- c. a CbCR comprising a statement relating to the allocation between countries of the income and activities of, and taxes paid by:
 - i. the taxpayer; and
 - ii. the other members of that group.

Tax audit procedure

Businesses with related party international dealings may face the risk of:

- a. a Client Risk Review ("CRR"); and
- b. a subsequent audit, with possible pricing adjustments and penalties.

Resources are allocated to TP cases according to the perceived risk to revenue posed by businesses not complying with the arm's length principle. The broader and more significant the scope of a business's international dealings with related parties, the more likely they are to be subject to a CRR.

A taxpayer will be at the greatest risk of a CRR if it:

- a. has significant levels of international dealings with related parties;
- b. pays less taxes compared to industry standards; or
- c. has recently undertaken business restructures that materially affect its related party international dealings.

The ATO usually examine the adequateness of intercompany TP only during risk reviews or tax audits. A risk review is generally conducted as an initial step, and, depending on the outcomes of a risk review, the ATO will decide whether a full tax audit is required. This will result where there is a perceived risk of significant underpayment of taxes or other non-compliance and will involve significantly more ATO scrutiny and cost compared to a CRR.

Risk reviews are undertaken at the discretion of the ATO, based on the risk criteria listed above. Typically, most large companies can expect to be audited every 5 years, with more intensive focus on those with an annual turnover exceeding AUD 200 million.

The ATO has continued its focus on targeting large corporate taxpayers specifically in relation to restructuring activities offshore (including migration of intangibles and creation of offshore hubs) and TP arrangements. Greater cooperation and transparency with offshore TAs is an increasing feature of this activity.

The International Structuring and Profit Shifting ("ISAPS") program has just completed its first 4-year funding cycle with a focus on international and TP issues and structuring activity that is believed to facilitate profit shifting opportunities. This has been a highly successful project and additional funding will be provided to enable this program to be continued for the immediate future.

Data analytics and risk assessment were important elements of the program which has involved analysis of key ratios and overall financial outcomes.

A key focus point for the ATO is to leverage data mined from International Dealing Schedules that are submitted with income tax returns where international related party dealings are disclosed.

The ATO are increasingly engaging in case resolution strategies including independent review, Alternate Dispute Resolution, APAs, and strategic litigation.

Income adjustment, surcharges, and penalties

PS LA 2014/2 explains when a taxpayer will be liable for penalties resulting from a TP audit, how the penalty will be assessed, and how the Commissioner's discretion in relation to remission should be exercised.

A penalty will be applied where an amended assessment gives rise to a shortfall (although an exemption to the shortfall penalties applies where the amount of the shortfall is equal to or less than a taxpayer's 'reasonably arguable threshold').

A base penalty amount ("BPA") is applied and calculated as a percentage increase pricing shortfall amount. The BPA ranges from 10 percent to 50 percent and will depend on whether the taxpayer entered into the scheme with the sole or dominant purpose of obtaining a TP benefit and/or has a RAP.

Shortfall penalties may be reduced upon voluntary disclosure to the Commissioner of the details of the shortfall.

A base penalty of 10 percent applies even where a taxpayer has a RAP and there was no sole or dominant purpose or intention in obtaining a TP benefit.

As an exemption to the scheme shortfall, penalties may apply where the amount of the 'scheme shortfall amount' is equal to or less than a taxpayer's reasonably arguable threshold. A taxpayer's scheme shortfall amount is the total amount of additional income tax and withholding tax payable arising from an ATO audit on the application of the TP rules. A taxpayer's reasonably arguable threshold is generally the greater of AUD 10,000 or 1 percent of a taxpayer's taxable income for the particular year.

A taxpayer cannot have a RAP for the purposes of calculating the BPA, where it has not met the TPD requirements in section 5 above.

Advance pricing agreements

A taxpayer can seek an APA from the ATO in the form of a private binding ruling. This is especially encouraged for multinationals with large transactions but equally encouraged for the SME market, where the understanding and compliance with the TP rules are not well understood or considered to be onerous.

An APA provides taxpayers an opportunity to reach an agreement with the ATO on the future application of the arm's length principle to their dealings with international related parties.

An APA establishes what TP methodologies should be used to determine arm's length prices or results for future transactions, agreements, or arrangements covered by the agreement.

An APA should, where possible, be concluded bilaterally through a MAP under the relevant DTA. The MAP would involve exchanges between the revenue authorities appointed under the relevant DTA.

During the application process, the ATO will discuss any issues with the taxpayer to facilitate the process.

APAs provide a mechanism for managing and mitigating TP risk by providing taxpayers with greater certainty on a prospective basis. Entering into an APA fosters a constructive working relationship with the ATO built on mutual trust established through early engagement and full and frank disclosure throughout the creation of the APA. Entering into an APA reduces the potential for double taxation on a taxpayer's covered cross-border dealings.

The operation of the APA will depend on the taxpayer complying with particular requirements, and certain critical assumptions being met. Where these have been adhered to, the ATO will be administratively bound by the terms of the APA and will not impose any additional income tax to that payable based on the pricing worked out under the APA on the covered cross-border dealings.

The APA generally covers a period of three to five years and may be reviewed if trading circumstances materially change. APAs are also subject to an annual reporting requirement.

Full details on the process for negotiating, implementation, and monitoring of an APA are set out in ATO guidance PS LA 2015/4.

Ex post measures to prevent double taxation

Australia is a signatory to the MLI. Once in force, the MLI will modify most of Australia's bilateral tax treaties to implement new integrity rules that will help prevent exploitation for tax avoidance purposes and improve Tax Treaty-based dispute resolution mechanisms.

The extent to which the MLI will modify these tax treaties will depend on the final adoption positions taken by each country. Australia notified its adoption positions on a provisional basis, to be confirmed upon ratification of the MLI.

Australia submitted a list of 43 Tax Treaties (vast majority) entered into by Australia and other jurisdictions that Australia would like to designate as Covered Tax Agreements ("CTAs"), i.e., Tax Treaties to be amended through the MLI. Only a small minority of Australia's DTA partners, including the US, have not been covered. Together with the list of CTAs, Australia also submitted a provisional list of reservations and notifications ("MLI positions") in respect of the various provisions of the MLI. The definitive MLI positions (which are not expected to vary widely from the provisional list) will be provided upon the deposit of its instrument of ratification, acceptance, or approval of the MLI. Australia has not yet formally ratified its final positions on the instrument. However, this is expected to happen early in 2018.

Mandatory Binding Arbitration – Part VI of the MLI (Articles 18 to 26) enables countries to include mandatory binding treaty arbitration (MBTA) in their CTAs in accordance with the special procedures provided by the MLI.

Australia has formulated the following reservations with respect to the scope of cases that are to be eligible for arbitration:

- Disputes which have been the subject of a decision by a court or administrative tribunal will not be eligible for arbitration, or will cause an existing arbitration process to terminate.
- Breaches of confidentiality by taxpayers or their advisors will terminate the arbitration process.
- Disputes involving the application of either Part IVA of the Income Tax Assessment Act 1936 (Australia's general anti-avoidance rule) or section 67 of the Fringe Benefits Tax

Assessment Act 1986) (arrangements to avoid or reduce fringe benefits tax) will be excluded from the scope of arbitration.

In this regard, Australia has expressly reserved its general anti-avoidance rule (which includes the Diverted Profits Tax ("DPT") and Multinational Anti-Avoidance Law ("MAAL")) from the binding MAP arbitration. This is undesirable as potential double taxation resulting from the application of the DPT and MAAL could remain unresolved indefinitely.

The provisional reservations and notifications made by Australia at the MLI signature is broadly consistent with the double tax treaty negotiation policies followed by Australia during previous years.

Australia has also signed TP agreements with certain non-DTA jurisdictions with which it has information exchange agreements.

From a bilateral perspective, all new DTAs contain a provision that is substantially the same as Article 25 of the Model Treaty. The taxpayer could apply for a MAP according to Art. 25 of the Model Treaty to prevent double taxation arising in case of a TP related income adjustment. Within a MAP, TAs of the involved countries consult each other to resolve disputes regarding the TP-related double taxation. If the involved TAs cannot agree upon a result, the taxpayer usually can apply for an arbitration procedure.

Intercompany financing

Companies have the following two alternatives for TP compliance relevant to intercompany financing:

1. Documenting application of low-level inbound loan safe harbour rules (if eligible – see section 11 below);
or
2. Preparation of TPD and benchmarking.

Both alternatives involve preparation of some documentation, but the content and work involved in compiling the document will vary between the two options.

If the taxpayer ‘ticks’ all the eligibility criteria for low level inbound loans, it will be required to prepare a simplified document explaining how the company complies with the criteria. A written loan agreement setting out the terms of the loan should be prepared and commentary provided on how it meets the arm’s length conditions.

If a company fails to comply with all the eligibility criteria, it will have to prepare complete TPD, which involves more than just demonstrating the interest rate is at arm’s length and requires a detailed analysis of the following:

1. Credit rating analysis of the borrower;
2. Demonstrating the borrower is capitalised in accordance with the arm’s length principle;
3. Demonstrating the intercompany loan is supported by commercial and financial reasons;
4. Analysing the application of the reconstruction powers provisions (Section 815-130); and
5. Benchmarking analysis of the interest rate.

The ATO have issued recent draft guidance in PCG 2017/D4 on applying the arm’s length principal to cross border related party financing arrangements. This follows a recent landmark Australian Court decision (Chevron’s case) where the ATO successfully argued the loan from Chevron US to Chevron Australia was incorrectly priced as ‘unsecured’ under the arm’s length principal and, thus, the interest rate charged was deemed to be too high.

The Courts took the view in support of the ATO position, that the parties need to take account of the interdependence between the parent and the subsidiary in relation to intragroup funding. This is likely to lead to stronger arguments by the ATO that subsidiaries should have a credit rating closer to that of their parent’s and reducing the interest rate charged on intragroup loans to arrive at the arm’s length rate.

The ATO guidance provides a range of ‘scores’ based on a number of identified risk factors with ‘risk zones’ ranging from ‘white’ (no risk) to ‘red’ (very high risk) where taxpayers should self- assess their TP exposures and take appropriate action to mitigate risk and penalties where appropriate.

Australia has well defined integrity laws and guidance (contained in Division 974 of ITAA 1997) and establish the appropriate classification of debt/equity funding instruments. The law applies a ‘substance over legal form’ approach and sets out a series of tests to determine whether an instrument is in substance debt or equity and, as a result, funding instruments may be reclassified as equity or debt for Australian taxation purposes under Division 974.

Australia has well established Thin Capitalisation rules (contained in Division 820 of ITAA 1997) and govern the deductibility of interest in Australia on outbound or inbound investment activities.

It is clear from the wording of paragraph 820-40(1)(b) of the law that the operation of Division 820 is limited to costs incurred by an entity in relation to a 'debt interest' issued by the entity, that it can otherwise deduct from its assessable income. Accordingly, all provisions relevant to deductibility, including the TP provisions, must be applied before Division 820 comes into operation.

Therefore, the TP provisions apply firstly to require an arm's length consideration for debt funding that is provided on a non-arm's length basis, with the Thin Capitalisation provisions then testing the amount of debt deductions available based on that consideration.

Accordingly, where an entity does not have 'excess debt', such that the Thin Capitalisation provisions in Division 820 would not result in the disallowance of any portion of the amounts comprising an entity's 'debt deduction', the TP provisions can still be applied to adjust the pricing of the consideration given to obtain and maintain the debt funding. The Australian Thin Capitalisation provisions have a general de-minimus threshold of AUD 2 million in Australian debt deductions before they are enlivened.

Australia has specific laws (contained in Division 245 of ITAA 1997) on the taxation treatment of forgiveness of 'commercial' loans and debts.

While net amounts forgiven are generally not treated as assessable income of the borrower, there is an ordering system where this amount is firstly used to reduce unused revenue and capital losses, then to reduce the tax cost base of revenue type assets such as plant & equipment and finally to reduce the Capital Gains Tax cost base of capital assets, with any remaining unused amounts permanently disregarded. The lender on the other side will generally obtain a revenue or capital loss for the net forgiven amount, depending on how the asset was held.

Safe harbour provisions/exemptions for SMEs

The ATO have released a range of safe harbours that enable some SME taxpayers to simplify their TP record-keeping requirements and eliminate the risk of an ATO TP review for an initial three-year test period. If an SME meets the safe harbour conditions and elects to apply the simplified record-keeping, the ATO will not review the TP records of the entity other than to confirm their eligibility to apply the concession(s).

ATO guidance in relation to the application of these new requirements is provided online and in PS LA 2014/3 "Simplifying TP record keeping".

Taxpayers that are eligible to take advantage of the simplified TP record-keeping options are required to continue to complete the International Dealings Schedule ("IDS") in all respects. Application of one or more of the simplified TP record-keeping options is evidenced by notating "Code 7" for the 'percentage of dealings with documentation code' in the IDS form.

The ATO simplification measures apply to the following low-risk taxpayers:

- Small taxpayers with turnover between AUD 0 and AUD25 million, with a cap on "specified service related-party dealings" (either as expenses or as income) of 15 percent of turnover; and
- Small distributors with turnover between AUD 0 and AUD50 million, provided they derive a "profit before tax ratio" of 3 percent or more.

In addition, “safe harbour” type arrangements also apply where taxpayers have:

- Certain intra-group service fee arrangements (discussed below); and
- Inbound loans of up to AUD 50 million (discussed below).

The main criteria to be satisfied if taxpayers are to be eligible to apply any of the safe harbour concessions are that taxpayers:

- a. Do not suffer “sustained losses”; defined as “losses for three consecutive years”;
- b. Do not have related party dealings with entities in “specified countries”; defined by way of a list of countries (generally regarded as tax havens);
- c. Have not undergone a “restructure” within the year; very broadly defined to include, inter alia, the disposal or acquisition of entities, the reduction, liquidation or relocation of business operations etc.;
- d. Have self-assessed compliance with the TP rules; this requires taxpayers to retain all records and documents necessary to adequately explain all transactions and calculation of amounts disclosed in their income tax return including documenting their positions to confirm their eligibility to apply the simplified record-keeping option(s).

The above eligibility criteria are common to all taxpayers that wish to take advantage of the simplified TP record-keeping options. In addition to the ‘common’ criteria, further conditions apply to each of the possible options (discussed below) and “small taxpayers” and “distributors” must not have:

- a. Related party dealings involving: royalties; licence fees, or R&D arrangements;
- b. Loans and guarantees (subject to ‘low level loans’ exclusion below); or
- c. International related-party dealings of a capital nature.

Intra-Group Services:

Taxpayers are eligible to apply the simplified record-keeping options for intra-group services if their international related party service dealings are either:

- AUD 1 million or less; or
- Greater than AUD 1 million, but for services an Australian taxpayer receives and/or provides – the total amount derived or charged by the taxpayer must not be more than 15 percent of the total revenue or expenses (as the case may be) of the Australian economic group.

In addition:

The mark-up on cost is:

- 7.5 percent (or more) for services provided; or
- No more than 7.5 percent for services received; and
- There are no “specified service related-party dealings”.

Related Party Inbound “Low-level Loans”:

The ATO has specified narrow eligibility criteria if taxpayers are to avail themselves of this simplification option. The criteria are as follows:

- The option applies to inbound interest-bearing loans and associated charges; that is, outbound loans are excluded from this option.
- “Combined cross-border loan” balance is AUD 50 million or less at all times throughout the year; defined to include all interest bearing and interest-free loan balances for amounts borrowed and loaned (without any net-off).
- The loans and related expenses must be denominated in Australian dollars and this must be reflected in loan agreements.
- The interest rate is no more than a specified Reserve Bank of Australia indicator lending rate for small business variable residential secured term.

The ATO have issued guidance in PCG 2017/2 outlining simplified TP record keeping options for SMEs.

Taxpayers are still required to maintain the general record keeping requirements under section 262A of the Income Tax Assessment Act 1936 that explain their TP transactions.

When a simplified option is selected, it must be done on the basis that the taxpayer has done all that they sensibly need to do in their circumstances to make sure their cross-border dealings satisfy the arm’s length principle as set out in Subdivisions 815-B or 815-C of the ITAA 1997.

While the ATO are to be commended for starting to address the question of TPD simplification measures, it is disappointing that the simplification measures currently apply to relatively few taxpayers. Accordingly, compliance with Australia’s TP rules will, for many taxpayers, continue to impose an administrative burden that is disproportionate to the risk of not complying with the TP rules.

TP and PEs (AOA)

Australia has not formally adopted the AOA approach to PE branch profit attribution.

Australian law adopts ‘old’ Article 7 of the Model Treaty by virtue of Subdivision 815-C of ITAA 1997. The object of this Subdivision is to ensure that the amount brought to tax in Australia by entities operating permanent establishments is not less than it would be if the PE were a distinct and separate entity engaged in the same or comparable activities under the same or comparable circumstances, but dealing wholly independently with the other part of the entity.

Further, Australian DTAs have ‘old’ (pre-2010) versions of Article 7, and Australia still formally applies a form of ‘Reasonable Business Activity’ (RBA) approach. This approach is confirmed in Subdivision 815-C and is also applied administratively by the ATO in taxation rulings TR 2001/11 and TR 2005/11.

Article 7 of an applicable DTA will override Subdivision 815-C if it produces a more favorable result for a taxpayer.

Subdivision 815-C recognises the approach of identifying ‘dealings’ between a PE and other parts of an enterprise. However, unlike the AOA approach, which is akin to a ‘Functional Separate Entity’ (FSE) approach, these provisions do not actually deem the ‘dealings’ of themselves, to produce income, expenses or profits and losses of the PE, rather those dealings are only taken into account in allocating the actual third-party income, expenses, or profits and losses of the entity to the PE.

Australia remains firm in its RBA-type approach, continuing to use old Article 7 in its most recently negotiated treaty with Germany (2015). This does leave the potential for different attribution outcomes and mismatches between countries who have adopted the AOA.

It is highly likely that Australia will adopt the AOA approach as some point in the future as it did not have any reservations with the new Article 7(2) or any negative observations on the related 2010 OECD Commentary. Given that a treaty by treaty approach may not be feasible, it may be better to adopt the AOA approach in full into Australian domestic law through Subdivision 815-C, consistent with the recent approach to modernising Australia's TP rules.

Other topics

a. Special rule for trusts and partnerships

Subdivisions 815-B and 815-C apply in relation to the 'net income of a trust' or the 'net income or loss' of a partnership in the same way those Subdivisions apply in relation to the taxable income of an entity other than a trust or partnership.

b. Reporting obligations for significant global entities

Subdivision 815-E of the ITAA 1997 enables the implementation of measures issued by the OECD relating to TPD and CbCR (including BEPS Action 13). This is discussed further in section 5 above.

Contact information

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Austria



Statutory rules/laws

- Statutory Law: Austrian Income Tax Code (*Einkommensteuergesetz*; (“EStG”)), Section 6 Item 6
- Regulations issued by the Austrian Ministry of Finance (binding for the Austrian TA): TP Guidelines 2010 (*Verrechnungspreisrichtlinien 2010*; (“VPR 2010”))

Definition of related party

Neither Austrian Statutory Law nor any regulations or guidances issued by the Austrian TA provide for a specific definition of related party for TP purposes. Therefore, the general definition as laid out in the OECD Guidelines should apply, (i.e., “two enterprises are associated enterprises with respect to each other if one of the enterprises meets the conditions of Article 9, sub-paragraphs 1a) or 1b) of the OECD Model Tax Convention with respect to the other enterprise”) or the respectively applicable Tax Treaty.

Treatment of the OECD Guidelines

The Austrian TA generally follows the OECD Guidelines. This also holds true with respect to the allocation of profits to permanent establishments under application of the AOA (see item 12 below). In reference to the application of the OECD Guidelines, it should be noted that Austrian TA generally follow a “dynamic” approach.

Accepted TP methods and priority

In general, the Austrian TA accepts all TP methods provided under the OECD Guidelines, including the traditional transaction methods, (i.e., the CUP Method, the RPM and the Cost Plus Method), as well as transactional profit methods, (i.e., the TNMM and the transactional PSM).

According to administrative guidance, the appropriateness of the TP method for a particular case should depend on the nature of the controlled transaction (functional analysis), the availability of reliable information (in particular on uncontrolled comparables), and the degree of comparability between controlled and uncontrolled transactions (including the reliability of potentially necessary comparability adjustments). Pursuant to paragraph 43 VPR 2010, where traditional transaction methods and transactional profit methods can be applied in an equally reliable manner, the traditional transaction methods shall be preferred. However, in cases where reliable gross margin information may neither be gained from publicly available information on third parties nor from internal comparables, transactional profit methods might be considered as the more appropriate methods.

Documentation requirements

Under Austrian tax law, taxpayers are generally obligated to meet adequate and orderly accounting principles for tax purposes. In case of transactions between associated enterprises, this includes documentation on the arm's length nature of TP in line with Article 9 of the OECD Model Treaty and §6(6) EStG. In this respect, the Austrian TP Guidelines explicitly refer to the general documentation requirements under Chapter V of the OECD Guidelines and the provisions on cost contribution agreements. Under certain conditions, more specific documentation requirements may have to be fulfilled. For instance, in case of business restructurings, paragraph 133 VPR 2010 states that the reasons for business restructurings have to be documented and, if the business restructuring aims at the achievement of synergy gains, such synergy gains have to be explained and substantiated.

The Austrian TA generally accepts TPD in line with the Resolution of the Council on a code of conduct on TPD for associated enterprises in the European Union ("EU TPD") as the basic set of information for the assessment of MNEs. However, pursuant to paragraph 309 VPR 2010, such TPD must be viewed within the framework of the OECD Guidelines and will not release the taxpayer from its obligation to provide additional information and documents upon specific request or during a tax audit (see also paragraph 18 of the annex of the EU TPD).

Further documentation requirements (Master File, Local File, and CbCR) may have to be met under the newly adopted Austrian TPD Act (*Verrechnungspreisdokumentationsgesetz*; ("VPDG")) (see below).

a. Filing deadline

There is generally no obligation to file the general TPD with the Austrian TA. However, in the case of a tax audit, the taxpayer must be in a position to provide such documentation.

Besides such general documentation, there may be more specific documentation requirements, e.g., as already mentioned, under the VPDG (see below). Respective Master Files and Local Files must be filed with the competent tax office within 30 days as from the filing of the underlying corporate income tax return. CbCR must be filed within 12 months as from the end of the business year.

b. Mandatory language

Based on the argument that German is the official language in Austria, the Austrian TA widely insists on the provision of documents in German, unless legal provisions explicitly allow for the provision of documents in another language. For instance, for purposes of the VPDG, CbCR, Master Files, and Local Files may be submitted in English. However, within their discretion, tax officers sometimes also accept other documentation in English.

c. Alignment with new Ch. V of OECD Guidelines/BEPS Action 13

As a consequence of the implementation of BEPS Action 13 (CbCR), Austria implemented respective reporting requirements in the VPDG with respect to business years starting as from January 1, 2016. Under such provisions, MNE groups of companies are obliged to provide a CbCR if the consolidated turnover is at least €750m. An Austrian resident business unit of a MNE group of companies is obligated to provide a Master File and a Local File if its turnover exceeded €50m in the two preceeding business years. If such turnover has not been exceeded, the Austrian resident business unit may, nevertheless, be obligated to provide a Master File upon request of the Austrian TA if another group entity triggers the obligation to establish such Master File in another state.

Tax audit procedure

As in many jurisdictions, tax audits in the area of TP gained major relevance over the last years in Austria. Tax officers are particularly educated to thoroughly investigate cross-border transactions from a TP perspective.

Depending on the size of the company, either the tax office (in case of “small” and “medium” sized company) or the so-called large companies’ tax audit (*Großbetriebsprüfung*; (“GBP”); in case of “large” size companies) is equipt for tax audits including TP issues. Furthermore, the Austrian Ministry of Finance employs a specialist group (*Fachbereich*) dealing with specific TP issues, which also supports the tax auditors upon request.

The Austrian TA does not have a published strategy on the conduct of TP audits in particular. In general, TP issues are dealt with in the course of ordinary tax audits. Therefore, the general guidelines regarding tax audits set out in the Organisational Handbook of the TA (*Organisationshandbuch der Finanzverwaltung*; (“OHB”)) apply to TP issues as well. The aim of such tax audits is to analyse all factual and legal circumstances relevant for the imposition of taxes. In general, in the course of preliminary proceedings, the tax auditors have to formulate an allegation to clarify the facts and to request respective further information and documentation. By answering such allegations, the taxpayer may bring forward arguments and exercises the right to be heard. It is also quite common that such allegations are orally discussed during the tax audit between the auditors, the taxpayer and the taxpayer’s representatives (i.e., tax advisor or tax lawyer).

In preparation for tax audits involving TP aspects, the provision of proper TPD is essential. During the appeal procedure before the Federal Tax Court (*Bundesfinanzgericht*; (“BFG”)), an oral hearing has to be scheduled if applied for by the taxpayer or if considered necessary by the court. Nevertheless, the main focus during the appeal procedure is on the written explanations of the taxpayer and the tax office. Oral hearings before the Austrian Supreme Courts are extremely rare.

In general, the tax office or the GPB are responsible for the assessment of the factual situation of the case. While the Federal Tax Court may further investigate such facts and decide the issue itself, the Austrian Supreme Courts are bound to the facts as they were determined by the lower tier instances and may, in general, only annul the decision of the Federal Tax Court. With respect to TP issues it should be noted that, the Austrian Supreme Administrative Court considers the attribution of profits as a question of facts to be answered by the lower tier instances (i.e. tax office, GPB and BFG). Therefore, TP issues are generally not dealt with by the Austrian Supreme Courts.

Income adjustment, surcharges, and penalties

Austrian TAs have the power to adjust the transfer prices to an arm’s length level, which is typically done in the course of tax audits. In cases where a transfer price chosen by the taxpayer is outside a generally accepted interquartile range, the price shall be adjusted to the median (rather than the edge of such a range; see paragraph 49 and 67 VPR 2010). If such adjustment is made by the other contracting state of a Tax Treaty, Austria is obligated to make counter adjustments pursuant to Art 9 of the Tax Treaty.

Such primary TP adjustments may also trigger secondary adjustments with respect to the taxpayer’s asset base or constructive dividends (potentially subject to withholding tax) or contributions, respectively. Furthermore, secondary adjustments may be required from a value added tax perspective. In addition, late payment fees amounting to 2 percent of the increased tax liability and, depending on the circumstances at hand, penalties of up to 200 percent (in case of criminal charges) may be applied.

Advance pricing agreements

Since 2011, Austrian tax law provides for a formal procedure to obtain binding tax rulings in the area of TP (as well as in the areas of reorganisations and group taxation), which are subject to an administrative fee between €1,500 and €20,000, depending on the turnover of the applicants.

Besides, particularly in areas not subject to binding tax rulings, taxpayers may obtain general tax rulings from the CA office. Although such rulings are not formally binding, they are subject to the principle of good faith and of high practical relevance, as the Austrian TA typically follows such rulings. They are not subject to an administrative fee.

Furthermore, taxpayers may request an expert opinion from the Austrian Ministry of Finance within the so-called "Express Answer Service" ("EAS"), which reflects the Ministry's general position in relation to international tax cases, including TP issues. From a legal perspective, such expert opinions are not binding, but in practice are followed by the tax offices. Such rulings are published on the website of the Austrian Ministry of Finance. They are not subject to an administrative fee.

Ex post measures to prevent double taxation

Austria signed the MLI with the reservation not to apply Art 3 (Transparent Entities), Art 4 (Dual Resident Entities), Art 8 (Dividend Transfer Taxation), Art9(1) (Capital Gains from the Alienation of Shares or Interests of Entities Deriving their Value Principally from Immovable Property), Art11 (Application of Tax Agreements to Restrict a Party's Right to Tax its Own Residents), Art 12 (Artificial Avoidance of Permanent Establishment Status through Commissionnaire Arrangements and Similar Strategies), Art 13(4) (Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions), Art 14 (Splitting-up of Contracts), Art 15 (Definition of a Person Closely Related to an Enterprise) if the reservations of Art 12(4), Art 13(6) and Art 14(3)(a) apply, the first sentence of Art 16(1) (MAP), and Art 26(4) with respect to Part VI as far as conventions already provide for mandatory binding arbitration of unresolved issues (currently Germany and Switzerland). Besides, Austria made certain reservations regarding the scope of Art 19 and Art 28(2) and notified, inter alia, that it would apply Option A under Art 5(1), Option A under Art 13 (1), apply part VI under Art 18 and apply Art 24(2) with respect to Art 24(1). Further details are published on the website of the OECD <http://www.oecd.org/tax/treaties/beps-ml-position-austria.pdf>

Tax Treaties are the typical means to avoid double taxation. Tax Treaties concluded by Austria are generally based on the Model Treaty. Therefore, most of Austria's Tax Treaties contain a provision similar to Art 25 of the Model Treaty regarding a MAP.

In general, such a MAP has to be initiated in the state of residence of the taxpayer. In case of a TP adjustment regarding an Austrian PE of a foreign company, the MAP has to be initiated in the state of residence of the foreign company. According to the Austrian Ministry of Finance, the same should hold true in case of groups of corporations. Therefore, if the foreign company chooses to establish a subsidiary (instead of a PE) in Austria, a MAP concerning TP adjustments made by the Austrian TA at the level of the subsidiary shall be initiated in the state of residence of the foreign group company (see para 352 VPR 2010). However, if the TP adjustment concerns two PEs or subsidiaries of a company resident in a third state, the MAP may be initiated in a PE state (see para 353 VPR 2010). In Austria, the Ministry of Finance is the CA with which a taxpayer may enter into MAPs. In case of oral hearings, it is up to the Ministry to compose the delegation negotiating the issue at hand.

In the course of a MAP, the taxpayer initiating such procedure has a right to be heard and can claim such right before the closing of the procedure, which may be especially relevant if the foreseeable outcome deviates from the application of the taxpayer. However, participation of the taxpayer in the oral hearing is internationally unusual. It may only be considered in parts of the negotiations if approved by the contracting state (see para 356 VPR 2010). In any case, it is not required that the taxpayer consents to the agreement of the negotiating authorities and its respective taxation. However, the understanding of the authorities is subject to the general appeals process. In case of a deviation from such understanding, the competent tax office has to inform the Austrian Ministry of Finance, which, in turn, informs the CA of the contracting treaty state to avoid non-taxation.

With respect to Germany, it should be noted that if the MAP is not closed within three years, the taxpayer initiating the procedure has the right to request to refer the case to the European Court of Justice (ECJ) and apply for an arbitration procedure pursuant to Art 273 TFEU.

In addition, the European Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises 90/463/EEC (the Arbitration Convention) provides an alternative to the MAP under Austrian Tax Treaties, where residents of EU Member States are potentially subject to double taxation. A respective application of the taxpayer has to explicitly refer to the Arbitration Convention. Otherwise, such an application will be interpreted as application for a MAP under the applicable Tax Treaty (see para 365 VPR 2010). If the CAs concerned fail to reach an agreement that eliminates the double taxation within two years of the date on which the case was first submitted to one of the CAs, they shall set up an advisory commission charged with delivering an opinion on the elimination of the double taxation in question. According to the Austrian Ministry of Finance, this two-year period commences as from the moment a final decision regarding the respective increase of income was made. A preliminary decision does not fulfil this requirement (see para 366 VPR 2010). Therefore, according to the Austrian Ministry of Finance, the two-year period does not commence as long as the period for filing an appeal before an Austrian Supreme Court is still open or, if such an appeal was filed, until the matter was decided by the Austrian Supreme Court (see para 368 VPR 2010). Although the Austrian TA is, in principle, not allowed to derogate from the decisions of the Supreme Courts, it is argued in legal doctrine that §48 of the Austrian Federal Tax Act (*Bundesabgabenordnung*; BAO) may constitute a basis to implement deviating decisions of the advisory commission.

Finally, §48 BAO provides for a general unilateral relief from double taxation by exempting (part of) the taxable income of crediting non-Austrian taxes if this is required to compensate Austrian and non Austrian taxation or to achieve the principle of reciprocity.

Intercompany financing

Based on the “substance-over-form” approach, Austrian TA may requalify debt into equity, for instance, in the case of a lack of sufficient equity in relation to the long term funding requirements of the business, inability of the borrower to obtain a loan at comparable terms from third parties, if the loan agreement grants rights to the lender similar to those of shareholders or in case of excessive debt financing, i.e., if debt to equity ratios are below the market standards. Despite the fact that there are no statutory rules on thin capitalisation in Austria, as a matter of administrative practice and case law, loans from related parties to an Austrian company may be considered as “hidden” equity rather than debt if the Austrian corporation is considered to be thinly capitalised. In such case, the interest is reclassified as dividends for Austrian tax purposes. From a practical point of view, the Austrian TA generally accepts a debt to equity ratio of around 3:1.

Regarding the arm's length interest rate, para 87 VPR 2010 states that, in line with general TP principles, the arm's length interest rate should be determined by application of the CUP Method, if comparable uncontrolled transactions can be determined at the money or capital market. However, if the CUP shall be determined by comparison to commercial banks, it would be necessary that either (i) 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 (ii) that reasonably accurate adjustments can be made to eliminate the material effects of such differences (see also para 2.14 OECD Guidelines). However, according to para 88 VPR 2010, a direct comparison between financing by commercial banks and intra-group financing should in many cases not be possible as commercial banks and other companies usually follow different entrepreneurial objectives. While the banking sector seeks to make business profits by lending money, other groups of companies usually aim at the maintenance of liquidity, an optimal allocation of capital within the group and an optimisation of interest income. Therefore, the debit interest rate applied by commercial banks shall only serve as an upper limit of the arm's length interest rates. Whether such an upper limit may be applied shall be dependent on the factual situation at hand and has to be assessed by the local tax office in consideration of currency and duration of the loan, the credit worthiness of the borrower, inevitable currency risks and possible refinancing cost vis-à-vis third parties. With respect to the credit worthiness of the borrower, it should also be considered that, within multinational groups of companies, the top company is usually in the position to influence the capital structure and, therefore, the credit worthiness of the borrowing group companies. Therefore, it is also considered to be within the sphere of influence of such a top company to provide collaterals for loans taken out by its group companies. As a consequence, pursuant to para 89 VPR 2010, only an interest rate for collateralised loans may serve as comparable interest rate. On the other hand, the credit interest rate of commercial banks may serve as comparable if the lending group company is in possession of sufficient liquidity because, in such a scenario, according to the Austrian TA, it cannot be expected that the financing of group companies will result in a higher profit than bank deposits (see para 90 VPR 2010).

Interest payments in connection with the debt-financed acquisition of shares are generally deductible. However, such deductibility is denied if the shareholding was acquired from a group company, even if the payments are made to third party creditors. Furthermore, Austrian tax law denies the deductibility of interest payments to low-taxed group companies. Such low-taxation criterion should be fulfilled if the recipient is not subject to tax due to an exemption (*ad personam* or *in rem*), subject to a tax rate below 10 percent, subject to effective taxation below 10 percent due to a specific relief or a refund of tax (including refund to the shareholders of the recipient).

The cancellation of debt by shareholders is typically considered as contribution into equity of the subsidiary. However, if the cancelled receivable is not fully recoverable, only the recoverable portion should be considered as contribution, while the non-recoverable portion increases the taxable profit of the subsidiary.

Safe harbour provisions/exemptions for SMEs

In general, Austrian tax law is consistently applied to all taxpayers and does not provide for explicit safe harbour provisions. As far as documentation requirements are concerned, it is to note that the VPDG (see item 5c above) does not cover companies below the mentioned thresholds. Further simplifications may apply with respect to accounting and disclosure requirements.

TP and PEs (AOA)

Generally, the Austrian TA agrees with the AOA for profit attribution to PEs. However, according to the Austrian TA, the AOA shall only be fully applicable if the revised version of Art 7 of the Model Treaty was implemented in the respectively applicable Tax Treaty.

If the applicable Tax Treaty does not follow the revised version of Art 7 of the Model Treaty, the AOA shall only be applicable as far as it is not in contradiction with the old wording of Art 7 of the Model Treaty. In this respect, it is to note that the Austrian TA generally applies a dynamic approach when it comes to the application of amendments to the OECD commentary and respective Austrian administrative practice. Therefore, amendments to the commentary, covered by the “old” wording of Art 7 of the Model Treaty, should be relevant for fiscal years starting after the first publication of the AOA.

Other topics

In general, it is to note that TP became more and more relevant over the last years. Such relevance was further increased since the adoption of the BEPS reports and the respective Directive by the Council of the European Union, triggering the mandatory implementation of several BEPS measures into domestic law of the EU Member States, including Austria.

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Brazil



Statutory rules/laws

The Brazilian legislation on transfer pricing is presented in the following regulations:

- Law no. 9.430/1996, articles 18 to 24; and
- Normative Instruction RFB nº 1.312/2012.
- Normative Instruction 1.681/2016

Definition of related party

An entity will be considered a related party to the legal entity domiciled in Brazil if:

1. the entity is a holding company of the legal entity in Brazil, when domiciled abroad;
2. the entity is a branch or subsidiary of the legal entity in Brazil, domiciled abroad; or
3. the individual or legal entity, resident or domiciled abroad, whose ownership interest in its capital stock characterises it as its parent company or affiliate, as defined in paragraphs 1 and 2, art. 243 of the Law of S.A.

There are other particularities as defined in art. 2 of the Normative Instruction RFB nº 1.312/2012.

Treatment of the OECD Guidelines

Brazil is not a country member of the OECD, but adopted international treaties to avoid double taxation, the Model Convention of the OECD. It is worth remembering that the methodology established for TP adopted by the OECD is not applied in Brazil, considering that Brazil has its own legislation with established methodology. Compared to other legal regimes worldwide, TP methods in Brazil are heavily criticised, because in fact it will be difficult to observe the Arm's length principle in the price practiced, or a range of margins or prices (that practiced between independent parties).

In this sense, the methods adopted by other countries foresee economic studies of transactions between unrelated parties to find the parameter price.

Thus, there is a careful selection of companies and transactions comparable to that of the company that is the object of the TP analysis.

Next, we look for the profit margin obtained in the transactions analysed applying different methods, to a certain extent, very similar to those in Brazil.

Accepted TP methods and priority

For import of goods, services or rights, the accepted methods are:

- Comparable independent price (“PIC”), equivalent to the comparable uncontrolled price (“CUP”);
- Resale price less profit (“PRL”), equivalent to the resale price method (“RPM”);
- Production cost plus method (“CPL”), equivalent to the cost plus method (“CPM”);
- Quotation price on imports (“CPI”)

For export of goods, services or rights, the accepted methods are:

- Export sales price (“PVEx”);
- Resale price method, considering 15 percent margin for wholesale and 30 percent margin for retail, equivalent to the RPM for export;
- Purchase or production cost-plus taxes and profit method (“CAP”), with a margin of 15 percent;
- Quotation price on export (“PECEX”)

Taxpayer may be relieved from the obligation of substantiate the export sales’ price on export if net revenues from export do not exceed 5 percent of the taxpayer’s total revenue. If this is satisfied, the export sales’ price charged to relate foreign may be proved only with export documents.

No adjust will be necessary if the actual import transfer price does not exceed the determined transfer price, or the difference is below 5 percent or 3 percent in case of PCI and PECEX methods.

Documentation requirements

a. Filing deadline

The documents capable of proving the production costs of the imported goods and services may be the copies of the documents based on the records in the accounting books, such as commercial invoices for the acquisition of raw materials and other goods or services used in production.

Spreadsheets apportionment of labor costs and copies of payrolls, proof of lease costs, maintenance and repair of equipment used in production, statements of the percentages and depreciation, amortisation or depletion charges used and of the losses and losses allocated, observing the provisions of paragraph 4 of art. 13 of IN SRF n° 243, of 2002.

It must also present the copy of the declaration of income tax delivered to the TA of the other country.

With regard to supporting documents for the export, copies of export declarations, export registers, exit invoices, commercial invoices and other documents proving the actual performance of operations and prices, in addition to the agreed contracts, must be presented.

However, in the absence of evidence considered sufficient or useful, the Treasury may determine the presentation of other documents, applying one of the methods discriminated by the current legislation.

The TP is filled with the income tax declaration, in specific forms, and the deadline is the last working day of July, referred to the last calendar year.

b. Mandatory language

The mandatory language is Portuguese.

c. Alignment with new Ch. V of OECD Guidelines/BEPS Action 13

Although Brazil is not a OECD member, the local TA issued Normative Instruction 1.681 on December 2016 to establish the annual filing of CbCR. The first CbCR will concern information relating to calendar year 2016.

The CbCR aims at a new standard of documentation to be required of multinational groups to subsidise, with information regarding their global operations, the tax administrations of the countries, especially the areas of selection and fiscal audits.

According to IN 1681, the taxpayer is obliged to deliver the CbCR (known as the Country-to-Country Declaration) for the integral entity resident for tax purposes in Brazil, which is the ultimate parent company of a MNE group. An entity that is a resident for tax purposes in Brazil that is not the final parent of a MNE group will be obliged to deliver the Country-to-Country Declaration of the group of which it is a party, for a given tax year, if it is verified by the least one of the following:

- the final controller of the multinational group to which it belongs is not obliged to deliver the Country-to-Country Declaration in their jurisdiction of residence for tax purposes;
- the jurisdiction of residence for tax purposes of the final controller has signed an international agreement with Brazil, but does not have an agreement of CA with the Country until the deadline for delivery of the Country-to-Country Declaration; or
- There has been a systemic failure of the jurisdiction of residence for tax purposes of the final controller of the multinational group that has been notified by the RFB to the resident entity for tax purposes in Brazil.

The Country-to-Country Declaration will be provided annually, in relation to the immediately preceding fiscal year, upon completion of the ECF (Fiscal Accounting Bookkeeping) and its transmission to Sped (Public Digital Bookkeeping System).

Tax audit procedure

TP should be reviewed as part of the tax audit or as specific audit procedure. The external audit procedure is required only for listed companies and “large companies” – company or group of companies under common control that has, in the previous fiscal year, a total asset greater than R\$ 240,000,000.00, or gross annual revenue exceeding R\$ 300,000,000.00.

For the purposes of proving the prices of imported goods, the presentation of a report by independent external auditors is permitted, in which it is observed that the value of the cost of acquisition of the goods was recorded in accordance with Brazilian legislation, together with an enumerative report of purchase invoices of the products by the related supplying company.

Any reports of foreign origin must be translated, notarised, consularised and registered in the Registry of Deeds and Documents, replacing copies of commercial invoices.

However, the presentation of the independent external auditors' report for the purposes of price verification does not prevent the possibility of requesting, during a review procedure, any other documents, such as commercial invoices for the entry of goods, provided for by Brazilian legislation.

Income adjustment, surcharges, and penalties

During a tax verification, the company has 30 days after the disqualification of the calculation presented, to present a new TP calculation and all the supporting documentation related to it. The tax inspector is not required to use the most favorable method available, most likely will use the easiest method to be applied considering the circumstances and measure income tax and social contribution at the maximum combined rate of 34 percent. The tax verification would not result in the true arm's-length, but on a price determined by the regulations.

If the conclusion is that there is a lack of TP adjustment, they will imposed penalties at the rate of 75 percent of the tax insufficiency. The rate may be reduced by 50 percent of the penalty if the company agrees to pay the tax insufficiency within 30 days not contesting the verification.

Advance pricing agreements

At this time, APA is not applicable in Brazil.

Ex post measures to prevent double taxation

As Brazil is not a member country of the OECD, the methods to be applied are restricted to those provided for in Brazilian legislation.

The agreements signed by Brazil to avoid double taxation do not determine which TP methods may be used, but only ensure to the signatory countries, within the limits of their respective laws, the possibility of applying controls aimed at curbing eventual artificial transfers of profits abroad.

Intercompany financing

Interest paid or credited to a related party, when arising from a contract not registered with the Central Bank of Brazil, will be deductible up to the amount that does not exceed the value calculated based on the Libor rate, for US dollar deposits for a period of six months, plus 3 percent annual spread.

In the case of contracts registered with the Central Bank of Brazil, interest will be admitted based on the registered rate (Law No. 9,430, of 1996, article 22, § 4).

Safe harbour provisions/exemptions for SMEs

There is a category of companies classified for tax calculation in a simplified form "Simples Nacional". These companies have sales up to R\$ 4.8 MM and have some specific activities. These companies are not subject to the transfer price.

TP and PEs (AOA)

The expenses paid or incurred by the Brazilian legal entity for the benefit of one of its affiliates domiciled abroad, due to cost sharing agreements, are nondeductible for the purposes of constitution of the income tax (IRPJ and CSLL). Since such expenses are related to the PE of the foreign company should not negatively impact the bases of calculation of these taxes in Brazil.

This understanding is in accordance with the provisions of arts. 5 and 7 of the OECD Model Treaty, respectively, concerning the definition of PE as well as the taxable profits of the contracting countries.

Other topics

Recent news related to TP in Brazil discusses the admission as a member of OECD:

Brazil “has much to move forward” until it is admitted as a member of the OECD, according to the director of the entity’s Center for Fiscal Policy and Administration, Pascal Sainmans. The application for membership was made by the Brazilian government at the end of May, but until the country is effectively accepted, there may be an interval of years.

The acceptance of the Brazilian request depends on a consensus among all members, said the director of the OECD. If the answer is positive, that the organisation is willing to initiate the process of a possible Brazilian adhesion, a schedule of negotiations will be established with the Brazilian government so that, among other points, Brazil will adapt to international tax standards, which, in practice, should have no effect on the population, but on the business environment.

“Brazil has a high level of taxation and no change is expected. The impact would be on business, revenue generation, elimination of double taxation, improvements in the business environment, while contributing to the fight against tax elusion and tax evasion,” said the OECD director.

Source: <http://epocanegocios.globo.com/Economia/noticia/2017/08/epoca-negocios-ocde-brasil-tem-muito-a-avancar-em-questoes-tributarias-para-ser-admitido.html>

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Canada



Statutory rules/laws

a. Law

- Section 247 of the Income Tax Act (“ITA”)

b. Circulars, memoranda, and folios

- IC 87-2R – International Transfer Pricing
- IC 71-17R5 – Requests for Competent Authority Assistance under Canada’s Income Tax Conventions
- IC 94-4R – International Transfer Pricing: Advanced Pricing Arrangements (APAs)
- IC 94-4R-(SR) – Advanced Pricing Arrangements for Small Businesses
- IC 06-1 – Income Tax Transfer Pricing and Customs Valuation
- Pacific Association of Tax Administrators (PATA) – Transfer Pricing Documentation Package
- TPM-02 – Repatriation of funds by Non-residents – Part XIII Assessments
- TPM-03 – Downward Transfer Pricing Adjustments under Subsection 247(2)
- TPM-04 – Third-Party Information
- TPM-05R – Requests for Contemporaneous Documentation
- TPM-06 – Bundled Transactions
- TPM-08 – The Dudney Decision: Effects on Fixed Base or Permanent Establishment Audits and Regulation 105 Treaty-Based Waiver Guidelines
- TPM-09 – Reasonable efforts under section 247 of the Income Tax Act
- TPM-11 – Advanced Pricing Arrangement (APA) Rollback
- TPM-12 – Accelerated Competent Authority Procedure (ACAP)
- TPM-13 – Referrals to the Transfer Pricing Review Committee
- TPM-14 – 2010 Update of the OECD Transfer Pricing Guidelines
- TPM-15 – Intra-group services and section 247 of the Income Tax Act
- TPM-16 – Role of Multiple Year Data in Transfer Pricing Analyses
- TPM-17 – The Impact of Government Assistance on Transfer Pricing
- S1-F5-C1 – Related Persons and Dealing at Arm’s Length

Definition of related party

The TP rules set out in section 247 apply to any transactions between a taxpayer and a non-resident person with whom the taxpayer does not deal at arm's length.

Section 251 of the ITA is the provision which deals with the concept of arm's length. Pursuant to paragraph 251(1)(a) of the ITA, related persons are deemed not to deal with each other at arm's length. The term "related persons" is defined in subsection 251(2) of the ITA as follows:

"related persons", or persons related to each other, are:

- a. individuals connected by blood relationship, marriage or common-law partnership, or adoption;
- b. a corporation and
 - i. a person who controls the corporation, if it is controlled by one person,
 - ii. a person who is a member of a related group that controls the corporation, or
 - iii. any person related to a person described in subparagraph (i) or (ii); and
- c. any two corporations
 - i. if they are controlled by the same person or group of persons,
 - ii. if each of the corporations is controlled by one person and the person who controls one of the corporations is related to the person who controls the other corporation,
 - iii. if one of the corporations is controlled by one person and that person is related to any member of a related group that controls the other corporation,
 - iv. if one of the corporations is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation,
 - v. if any member of a related group that controls one of the corporations is related to each member of an unrelated group that controls the other corporation, or
 - vi. if each member of an unrelated group that controls one of the corporations is related to at least one member of an unrelated group that controls the other corporation.

For the purposes of subsection 251(2), control is de jure control, which generally means the right of control that rests in ownership of such number of shares as carries with it the right to a majority of the votes in the election of the board of directors of the corporation.

In determining control, the ITA contains provisions which deem certain share or share related transactions to have taken place in determining the ownership of shares of the capital stock of a corporation where a person has a right under a contract in equity or otherwise, either immediately or in the future and either absolutely or contingently, related to such share and share related transactions.

Unrelated persons can also be considered not to be dealing at arm's length with each other. Paragraph 251(1)(c) states that it is a question of fact whether persons not related to each other are, at a particular time, dealing with each other at arm's length.

The following criteria have been used by the courts in determining whether unrelated parties to a transaction are not dealing at arm's length:

- whether there is a common mind which directs the bargaining for both parties to a transaction;
- whether the parties to a transaction act in concert without separate interests; and
- whether there is de facto control.

Treatment of the OECD Guidelines

The OECD Guidelines are referred to and are endorsed by Canada Revenue Agency ("CRA") in many of its administrative publications.

CRA uses the OECD Guidelines in its administration of the ITA. Nevertheless, the OECD Guidelines are not law. With respect to TP, CRA and the taxpayer are bound by section 247 of the ITA and any other applicable provisions in the ITA, as well as the provisions in the various Tax Treaties that Canada has with other countries. However, if a taxpayer uses a TP method other than one that is included in the OECD Guidelines, it is very likely that method will be challenged by CRA on audit.

Accepted TP methods and priority

Canada's TP legislation incorporates the arm's length principle and, for tax purposes, it requires that the terms and conditions agreed to between non-arm's length parties be those that one would have expected had the parties been dealing with each other at arm's length.

CRA endorses the OECD Guidelines' TP methods. Additionally, CRA's view is that there is a natural hierarchy in the methods. Certain methods provide more reliable results than others, depending on the degree of comparability between controlled and uncontrolled transactions.

CRA takes the same view as the OECD Guidelines, giving preference to the traditional transaction methods over the transactional profit methods, and the transactional profit methods are used as methods of last resort when the use of traditional transaction methods cannot be reliably applied or cannot be applied at all.

Under CRA's Informational Circular ("IC") 87-2R, CRA states the CUP Method, if applicable, clearly provides the highest degree of comparability for the traditional transaction methods because it:

- focuses directly on the price of a transaction; and
- requires both functional and product comparability.

CRA goes on to say that although the CUP Method provides the most direct and reliable means of establishing an arm's length price, other traditional transaction methods may have to be used where:

- there is not enough quality information available with respect to uncontrolled transactions; or
- it is not possible to reliably quantify the differences between controlled and uncontrolled transactions.

The Cost Plus and Resale Price methods operate at the gross margin level, therefore, product differences have a less significant impact on the reliability of the results than in the CUP Method.

If the CUP Method is not appropriate in the specific circumstance, the choice between the Cost Plus Method or the RPM will depend on the comparability of quality data available. The Cost Plus Method begins with the costs incurred by a supplier of a product or service to a non-arm's length person, and a comparable gross mark-up is then added. The RPM begins with the resale price to arm's length parties (of a product purchased from a non-arm's length person), reduced by a comparable gross margin.

Taxpayers will have to consider the transactional profit methods if:

- no quality data is available to apply the Cost Plus or Resale Price methods; or
- the available data to apply the Cost Plus or Resale Price methods have material differences that cannot be reliably adjusted.

If a transactional profit method must be used, CRA is of the view that the PSM will generally provide a more reliable estimate of an arm's length result than the TNMM, unless a high degree of comparability, including the comparability of intangible assets, can be established.

Documentation requirements

TPD in Canada is required. Taxpayers or partnerships have to have prepared or obtained records or documents which provide a description that is complete and accurate in all material respects of:

- the property or services to which the transaction relates;
- the terms and conditions of the transaction and their relationship, if any, to the terms and conditions of each other transaction entered into between the participants in the transaction;
- the identity of the participants in the transaction and their relationship to each other at the time the transaction was entered into;
- the functions performed, the property used or contributed, and the risks assumed for the transaction by the participants in the transaction;
- the data and methods considered and the analysis performed to determine the transfer prices or the allocations of profits or losses or contribution to costs, as the case may be, for the transaction; and
- the assumptions, strategies, policies, if any, that influenced the determination of the transfer prices or the allocation of profits or losses or contribution to costs, as the case may be, for the transaction.

The documentation does not get filed annually with the tax return. There are no thresholds that would allow SMEs to avoid the documentation requirements. However, there is a form which is required to be filed annually to report non-arm's length transactions with non-residents – form T106. There is a threshold with respect to the filing of form T106 – the form is not required to be filed if the aggregate fair market value of the taxpayer's total reportable transactions for all non-residents combined is CDN\$1,000,000 or less (the de minimis exemption). Form T106 is filed separately from the tax return.

If form T106 is not filed on a timely basis or if there are false statements or omissions on the form, penalties are applicable.

If any TPD that is submitted to CRA is not in English or French, the taxpayer must provide an official translation within 30 days of a request by CRA.

CRA did not adopt the EU TPD

Tax audit procedure

Generally, a TP audit will be conducted in the same fashion as any other audit under the ITA. With a TP audit, the CRA auditor will be looking to see that transaction prices between the taxpayer and related non-residents are economically sound, and that they agree with CRA's TP approach.

Tax services offices are responsible for identifying taxpayers who may have failed to make reasonable efforts to determine and use arm's length prices as part of the normal audit review.

If it becomes apparent that a TP assessing position may be recommended, the auditor will likely seek assistance from the appropriate International Advisory Services Section.

The information the International auditor will generally request first is the taxpayer's contemporaneous documentation which supports the amount of the transfer prices that were used. The request for contemporaneous documentation must generally be made in writing and the taxpayer must provide the information within three months from the date of the request.

Contemporaneous documentation is required to be kept by the taxpayer pursuant to subsection 247(4) of the ITA. If a taxpayer does not have contemporaneous documentation, then the taxpayer will be deemed, pursuant to subsection 247(4), not to have made reasonable efforts to determine and use arm's length prices or arm's length allocations in respect of a transaction.

After the audit has been completed if the international auditor does not agree with the transfer prices that the taxpayer has used, the auditor will issue an assessment for an adjustment. At this point, if the taxpayer disagrees with the assessment, the appeals process will begin.

The first step in the appeals process is to file a Notice of Objection ("N.O.") on a timely basis. The N.O. will be reviewed by a separate division of CRA.

The CA review process can be started without having to wait for CRA's decision on the N.O. Generally, CRA will agree to put the N.O. aside until the CA review process has been completed. The CA review is done through the MAP process, which is discussed in more detail under section 9 – "Ex Post Measures to Prevent Double Taxation" below. If the CA review undertaken by CRA does not produce a satisfactory result for the taxpayer, the filing of a N.O. will keep the taxpayer's appeal rights under the ITA open.

The CA review process deals only with TP adjustments and not penalties. Penalties can only be appealed by filing a N.O. with CRA.

If the N.O. is not successful, the taxpayer can then take the case to court. The appeals process, even before getting to the court stage, is a long and arduous process.

Income adjustment, surcharges, and penalties

If TP adjustments are not in line with the arm's length principle, penalties will apply. The penalty is equal to 10 percent of the net result of certain adjustments for the particular year. The adjustments are calculated as follows:

- the total of the TP income and capital adjustments (upward adjustments, whether there are reasonable efforts or not);

minus

- the total of TP income and capital adjustments for which a taxpayer has made reasonable efforts to determine and use arm's length transfer prices or arm's length allocations (upward adjustments for which there are reasonable efforts); and
- the total of TP income and capital setoff adjustments for which a taxpayer has made reasonable efforts to determine and use arm's length transfer prices or arm's length allocations (downward adjustments for which there are reasonable efforts).

If the taxpayer has not made reasonable efforts to determine and use arm's length prices or allocations, there is no reduction in the amount of the penalty.

The penalty will apply only where the net amount calculated above exceeds the lesser of CDN\$5,000,000 and 10 percent of the taxpayer's gross revenue for the year.

CRA will determine the amount of the TP adjustment based on the arm's length principle as previously discussed (the terms and conditions agreed to between non-arm's length parties be those that one would have expected had the parties been dealing with each other at arm's length).

The TP adjustment will result in an increase to taxable income resulting in additional income taxes payable plus interest.

The TP adjustment may result in the assessment of Part XIII tax (including interest and penalties), which is withholding tax applied to benefits considered to have been conferred on a non-resident person attributable to a TP adjustment. These benefits are generally deemed to be dividends paid by a corporation resident in Canada to a non-resident person subject to Part XIII withholding tax.

Advance pricing agreements

Canada has an APA program, which is administered through CRA's Competent Authority Services Division ("CASD"). The CASD is part of the International and Large Business Directorate.

Different types of APAs may be entered into by a taxpayer including unilateral APAs, bilateral APAs, and multilateral APAs.

The APA process includes the following stages:

- pre-filing meeting(s);
- the APA request;
- the acceptance letter;
- the APA submission;
- preliminary review of the APA submission and establishment of a case plan;
- review, analysis, and evaluation;
- negotiations,
- agreements;
- the post settlement meeting; and
- APA compliance.

There is a user charge which must be paid to CRA. The user charge will be outlined in the acceptance letter. CRA publishes an annual APA program report.

Canada allows a taxpayer to apply for a rollback with the APA request if certain criteria are met. In Transfer Pricing Memorandum (“TPM”)-11, CRA states:

The CRA will usually consider a request to expand the period of an APA to cover transactions in open taxation years where:

- a request for contemporaneous documentation has not been issued by a tax services office (“TSO”);
- the facts and circumstances are the same;
- the foreign tax administration and relevant TSO have both agreed to accept the APA rollback request; and
- appropriate waivers have been filed.

CRA also has a streamlined APA process for taxpayers that meet certain conditions. The key elements of the Small Business APA program are:

- CRA’s CASD administers the program.
- The program has a fixed non-refundable administrative fee of CDN\$5,000.
- Taxpayers must have gross revenue of less than CDN\$50 million or a proposed covered transaction of less than CDN\$10 million to be considered for the program.
- The program covers only transactions of tangible goods (which have not been bundled with non-routine intangibles) and routine services.
- Site visits are not performed. The only material CRA requires the taxpayer to submit is a functional analysis.
- Only requests for a unilateral APA, without rollback, are accepted into the program.
- Annual reporting under the program is limited to stating, in writing, whether the critical assumptions have or have not been breached.

Ex post measures to prevent double taxation

MAP is the only mechanism under Canada’s network of Tax Treaties to relieve double taxation or taxation not in accordance with a convention.

In addition to the APA program discussed above, the CASD also has responsibility for the MAP program.

CRA publishes an annual MAP program report.

When the CRA receives a MAP request from a taxpayer, the request is entered into its internal tracking system and assigned to one of the four MAP-APA Sections or to the MAP-Technical Cases Section.

The MAP is then assigned to a lead analyst, who is responsible for the review, analysis, negotiation, and resolution of the MAP case.

Intercompany financing

CRA has stated, in IC 87-2R, as a general rule, the specific provisions of the ITA (sections 17 and 80.4, and subsections 15(2) and 18(4)) relating to loans and other indebtedness to or from non residents would be applied before considering the more general provisions of section 247. The specific provisions deal with situations in which a Canadian corporate taxpayer:

- does not charge an adequate rate of interest on a loan or other indebtedness to a non resident (an adequate rate of interest is prescribed by Regulation under the ITA);
- receives an interest-free or low-interest loan from a non-resident; or
- is thinly capitalised (in general, the thin-capitalisation rules limit the debt/equity ratio for Canadian subsidiaries of non-residents to 1.5:1).

Safe harbour provisions/exemptions for SMEs

There are no safe harbour rules in Canada for specific types of transactions.

There is a streamlined process for APAs for Small Business. The streamlined process is discussed in more detail above under section 8 "Advance Pricing Agreements" above.

TP and PEs (AOA)

Canada has effectively adopted the AOA with the US, but not with any other countries.

CRA has stated the AOA is a two-step process which generally applies the OECD Guidelines to determine the profits of a PE. The first step is a functional and factual analysis that requires the attribution of functions, risks, and assets to the PE to hypothesise the PE as a separate entity. The second step involves the pricing of recognised dealings based on those OECD Guidelines. This two-step process might result in the recognition of notional dealings and, consequently, notional expenses.

CRA maintains its view that notional expenses are generally not allowed in determining profits attributable to a PE because paragraph 4(b) of the Income Tax Conventions Interpretation Act ("ITCIA") prevents such deductions. However, under the terms of paragraph 4(b) of the ITCIA, this prohibition will not apply to disallow the deduction of notional expenses where an agreement has been entered into between the competent authorities of the parties to the particular Tax Treaty in question and such agreement expressly so provides. To date, Canada has entered into only one such CA agreement – the one with the US.

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China



Statutory rules/laws

- Sec. 36 Law of the People's Republic of China Concerning the Administration of Tax Collection ("TCL") as of Sep 4, 1992, last revision on Apr 24, 2015;
- Sec. 41-48 Enterprise Income Tax Law of the People's Republic of China ("EITL") as of Mar 16, 2007, last revision on Feb 24, 2017;
- Sec. 51-56 Detailed Rules for the Implementation of the Law of the People's Republic of China on the Administration of Tax Collection ("DIR of TCL") as of Sep 7, 2002, last revision on Feb 6, 2016;
- Sec. 109-123 Detailed Implementation Regulations on the Implementation of the Enterprise Income Tax Law (DIR of EITL) as of Dec 6, 2007;
- Circular of the State Administration of Taxation ("SAT") on the Issuance of the Implementation Measures for Special Tax Adjustments ("Trial Implementation") (Guo Shui Fa [2009] No. 2);
- SAT Announcement on Implementation Measures of Mutual Agreement Procedures under Tax Agreements (SAT Announcement 2013 No. 56);
- SAT Order on Administrative Measures of the General Anti-Avoidance Rules (Trial Implementation) (SAT Order [2014] No. 32);
- SAT Announcement on Regulating the Administration of Cost Sharing Arrangements (SAT Announcement 2015 No. 45);
- SAT Announcement on Administrative Enhancement of Related Party Transactions Reporting and Contemporaneous Documentation (SAT Announcement 2016 No. 42);
- SAT Announcement on Administrative Enhancement of Advance Pricing Arrangements (SAT Announcement 2016 No. 64);
- SAT Announcement on Administrative Measures of Special Tax Investigations, Adjustments and Mutual Agreement Procedures (SAT Announcement 2017 No. 6);

All referred to collectively as the "China TP Regulations"

Definition of related party

The term "related party" is defined in sec. 51 of DIR of TCL.

According to this provision, a company, enterprise, or other economic organisation is to be qualified as related to a Chinese taxpayer if one of the following requirements is met:

- direct or indirect ownership or control in terms of capital, business operations, selling and purchasing, etc.;
- being directly or indirectly under the common ownership or control of a third party;
- another affiliation of interests.

Further definitions and examples of related party refer to sec. 109 DIR of the EITL, and sec. 2-3 of SAT Announcement 2016 No. 42.

Treatment of the OECD Guidelines

In general, the Chinese TP Regulations are in line with the OECD Guidelines. The arm's length principle and TP methodologies of the OECD Guidelines are largely adopted in the China TP Regulations. However, there are also some notable differences, such as:

- The elective, simplified approach for low value-adding intra-group services is not introduced;
- The concept of hard-to-value intangibles is not applied in the China TP Regulations;
- A DEMPEP approach is applied for intangible assets. The final 'P', which is extra to the DEMPE approach in OECD Guidelines, refers to 'Promotion'. This reflects the emphasis of China on its Location-Specific Advantages due to the vast market and consumer awareness. However, the DEMPEP approach does not describe 'the more important functions' which are critical in the value creation of intangibles in the DEMPE approach in the OECD Guidelines;
- A broad word 'other methods' is additional to the specific TP methods introduced in the China TP Regulations. This implies that the Chinese TA could apply other appropriate methods including a value chain analysis, which has been emphasised by China.

Accepted TP methods and priority

In general, the Chinese TA accepts the TP methods described in the OECD Guidelines (described in Sec.16-22 of SAT Announcement 2017 No. 6).

There is no statutory hierarchy or preference in TP methods. Instead, the most appropriate method for the transaction under review is to be used. In this respect, a comparability analysis is to be carried out to identify the most appropriate method.

In practice, the TNMM seems to be the most common method, since it was used by 78 percent of all the applied TP methods for APAs from 2005 to 2015, according to the 2015 Annual APA Report of SAT. However, the SAT Announcement 2017 No. 6 does state that it is not encouraged to apply TNMM where significant intangible assets are involved.

Documentation requirements

a. Filing deadline

The Enterprise Annual Related Party Transactions Reporting Forms, which include the CbCR, are required to be filed by May 31 of the following year;

Local File and Special Item File have to be filed by Jun 30 of the following year;

Master File must be prepared within 12 months from the end of financial year of the ultimate holding company;

Contemporaneous documentation should be provided within 30 days upon the request of the Chinese TA.

b. Mandatory language

The CbCR is required to be prepared in both Chinese and English. All the other documents are generally required to be in Chinese.

c. Alignment with new Ch. V of OECD Guidelines/BEPS Action 13

Overall, TPD in China aligns with BEPS Action 13, while the 'Special Item File' includes required documentation regarding Cost Sharing Arrangements and Thin Capitalisation. According to the SAT Announcement 2016 No. 42:

Taxpayers need to prepare the CbCR in their annual related party transaction reporting under either of the following two situations:

- The resident taxpayer is the ultimate holding entity of a multinational group and the annual consolidated revenue of the group in the previous financial year is over RMB 5.5 billion (ca. €698 million¹);
- The company has been appointed by the group to submit the CbCR.

Taxpayers are obliged to prepare the Master File if one of the following criteria is met:

- The ultimate holding company of the taxpayer with cross-border related party transaction has prepared a Master File; or
- Annual related party transactions are more than RMB 1 billion (ca. €126.9 million)

Taxpayers are required to prepare the Local File if the annual related party transactions meet any of the following criteria:

- The amount of tangible assets ownership transfer is more than RMB 200 million (ca. €25.4 million)
- The amount for financial assets transfer is more than RMB 100 million (ca. €12.7 million)
- The amount for intangible assets ownership transfer is more than RMB 100 million (ca. €12.7 million)
- The amount for all other related party transactions is more than RMB 40 million (ca. €5.1 million)

Taxpayers is obliged to prepare the Special Item File when:

- they have signed or are implementing a Cost Sharing Arrangement; or
- the related party debt-to-equity ratio exceeds the stipulated ratio and the explanation of compliance with an arm's length principle is needed.

Moreover, SAT Announcement 2017 No. 6 stipulates that companies that engage in single-function of manufacturing (toll or contract manufacturing), contract R&D, or distribution with overseas related parties are required to prepare the Local File for years having losses regardless of the thresholds stated above.

Tax audit procedure

The Chinese TA administers special tax adjustment risks by means of monitoring the Enterprise Annual Related Party Transactions Reporting Forms, contemporaneous documentation, and profit levels. A 'Tax Matters Notice' could be issued to a taxpayer when Chinese TA identifies special tax adjustment risks.

¹RMB/EUR at 1:7.88 for all relevant amounts.

Taxpayers could adopt a self-adjustment by filling out a special form upon receipt of such a Tax Matters Notice or identifying special tax adjustments on their own. Chinese TA should initiate the special tax adjustment investigation procedures when enterprises require to confirm special tax adjustment matters such as pricing principles and methods of related party transactions.

Enterprises with the following characteristics shall typically attract particular attention of the Chinese TA for a TP audit:

- enterprises with significant amount or numerous types of related party transactions;
- constant loss-making enterprises, enterprises with low profitability or volatile results;
- enterprises with a lower profitability than other enterprises in the relevant industry;
- enterprises with profitability that does not match their function and risk profile, or whose shared benefits do not match shared costs;
- enterprises dealing with related parties in countries or regions with low taxes;
- enterprises with a lack of compliance of contemporaneous documentation or the annual related party transactions reporting requirements;
- enterprises whose related party debt-to-equity ratio exceeds the stipulated level;
- enterprises, controlled by resident companies or jointly by resident companies and Chinese nationals, who are established in countries or regions where effective tax burden is lower than 12.5 percent and distribute no retained earnings or reduce distributions without reasonable business needs; and
- enterprises which engage in tax planning or arrangements without reasonable business purposes.

The Chinese TA is empowered to request information from not only the audit target (either a resident or a non-resident company) but also its related parties as well as other relevant parties by means of electronic data, questioning or on-site investigation. Certain qualified enterprises, who are involved in APAs with the Chinese TA, do not fall into the audit scope.

Where no tax adjustment is identified during the audit, the Chinese TA will issue a 'Special Tax Investigation Conclusion Notice' to the audit target. If tax adjustments are identified, a 'Special Tax Investigation Adjustment Notice' will be issued by going through certain procedures with the Chinese TA. The audit targets may file an application for administrative reconsideration and subsequent administrative litigation after paying off the tax, interest, and overdue fine or providing collaterals if they disagree with the proposed special tax adjustments.

Income adjustment, surcharges, and penalties

According to the TCL, if the taxpayer:

- fails to file the annual related party transactions reporting forms, or
- does not maintain the contemporaneous documentation or other relevant documents, then, a penalty of RMB 2,000 (ca. €253.8) to RMB 50,000 (ca. €6,345.2) could be assessed.

Furthermore, if the taxpayer:

- refuses to provide contemporaneous documentation and other information on related party transactions,
or

- provides false or incomplete information that does not truly reflect the situation of their related party transactions, then, the taxpayer could be subject to a penalty which ranges from RMB 10,000 (ca. €1,269) up to RMB 50,000 (ca. €6,345.2).

In case of TP adjustments, a special interest levy is stipulated in the SAT Announcement 2017 No. 6, which is based on the RMB loan rate published by the People's Bank of China, plus penalty interest rate of 5 percent. The penalty interest can be waived if related party transactions reporting forms are filed and contemporaneous documentation is prepared.

If the adjusted tax has not been paid after the informed deadline, an overdue fine at an annualised rate of 18.25 percent will come into effect to replace the interest.

Advance pricing agreements

If a taxpayer wants to apply for an APA, in general, the following requirements are cumulatively to be met:

- the annual amount of related party transactions is over RMB 40 million (ca. €5.1 million, usually covers 3 years in a row prior to the acceptance of the application by the Chinese TA);
- the taxpayer complies with the related party disclosure requirements; and
- the taxpayer prepares, maintains, and provides contemporaneous documentation in accordance with the requirements.

According to SAT Announcement 2016 No. 64, the term of an APA normally covers 3 to 5 years. With application of the company and approval of the Chinese TA, an APA may be rolled back for the same related party transactions for a maximum period of 10 years. Although a taxpayer with an effective APA is exempted from the contemporaneous documentation requirements, it is required to file an annual APA compliance report, in both electronic and paper format, with the Chinese TA within 6 months from the end of each year. Both the Chinese TA and the APA application company can suspend or terminate the APA procedures before an APA is signed.

Ex post measures to prevent double taxation

China has signed the MLI on Jun 7, 2017. China has generally opted in to the provisions of the MLI, which represent the minimum standards with opting out of some non-mandatory provisions such as Article 10, 12 and 13 with regard to PE, and the arbitration clause under Article 16 – MAP.

According to SAT Announcement 2017 No. 6, a taxpayer who intends to invoke the MAP for special tax adjustment cases should submit written documents to the SAT. Taxpayers who are under special tax investigations or who have not paid taxes concluded by an investigation may not be eligible for the MAP.

Intercompany financing

Determination of debt v. equity

According to Sec. 119 of the DIR of EITL, "Debt investment" as mentioned in Sec. 46 of the EITL refers to financing that is directly or indirectly obtained by an enterprise from its related parties, and that is to be repaid in principal and interest or to be compensated in ways similar in nature to paying interest. "Equity investment" as mentioned in Sec. 46 of the EITL refers to investments received by an enterprise without the obligation to repay principal and interest, and through which investors possess ownership rights in the net assets of the enterprise.

Arm 's length interest rate

Despite no direct definition of an arm's length interest rate, the lending rates published by the People's Bank of China and borrowing rates with other banks for similar loans could be references in practice.

Deductibility of interest

According to Sec. 41 of EITL, interest expenses which are not on an arm's length basis could be adjusted by the Chinese TA with reasonable methods.

Sec. 46 of EITL stipulates that interests resulted from debt investments from related parties, which exceeds the regulated debt-to-equity ratio, are not deductible for EIT filing.

The regulated debt-to-equity ratio for financial enterprises is 5:1 while that for other enterprises is 2:1.

Loan write off treatment

Written-off loans for a borrower are considered as income in normal cases.

Safe harbour provisions/exemptions for SMEs

Eligible resident SMEs can enjoy an effective CIT rate of 10 percent in contrast with the standard rate of 25 percent. Eligible SMEs are defined as enterprises which are in non-prohibited or non-restricted industries and

- For industrial companies:
 - Annual taxable income is no more than RMB 500,000 (ca. €63,451.8)
 - Headcount is no more than 100;
 - Total asset is no more than RMB 30 million (ca. €3.8 million).
- For other companies:
 - Annual taxable income is no more than RMB 500,000 (ca. €63,451.8)
 - Headcount is no more than 80;
 - Total asset is no more than RMB 10 million (ca. €1.3 million).

No safe harbour provisions for SMEs are available regarding TP requirements.

TP and PEs (AOA)

AOA has not been applied by China.

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Croatia



Statutory rules/laws

a. Law

The Corporate Income Tax Act ("CIT Act") – Article 13:

- tax base adjustments for the profits below arm's length;
- related parties;
- methods: in line with the OECD Guidelines;
- method hierarchy (legislation, OECD Guidelines);
- liability of information disclosure for related parties and their business transactions, methods used and reasons for using the selected method must be provided;
- responsibility of local companies to prepare TPD.

b. Statutory ordinances

Ordinance on the Profit Tax Act – Article 40, which sets out:

- identification of the selected method;
- description of the information considered, and reasons to use a selected method;
- assembly of documentation which would underline comparability, functional analysis and risk analysis;
- calculations;
- prior year documentation updates;
- the business relations between related entities will only be recognised if a taxpayer provides the previously mentioned information.

Definition of related party

According to the CIT Act, the definition of related parties is provided in Article 13, Paragraph 2. Parties are recognised as being associated if one of them participates, directly or indirectly, in the management, control or capital of the other party or if the same person participates, directly or indirectly, in the company's management, control or capital.

The obligation to have TPD is imposed to taxpayers who have transactions with foreign related parties, but also to those who are dealing with resident related parties, where one party has preferential tax status, i.e. pays profit tax at the decreased tax rate or has the right to utilise tax losses carried forward from the past periods.

Further definitions of related parties are provided in the General Tax Act and Company Act stating that associated parties are legally independent companies which in their mutual relations have the status of:

- a company which holds a majority share or majority decision-making interest in another company (according to the General Tax Act, article 41),
- dependent and controlling companies (according to the Company Law, article 475, any legally independent company upon which another company is regarded as a dependent or subordinate company. Companies in a concern (a main company and one or more dependent companies united under one common management provided by the main company), under the Company Law, article 476,
- companies with mutual (reciprocal) shares (companies with headquarters in Croatia which are joined in such a manner that each company holds more than 25 percent of the shares in the other company), under the Company Law, article 477,
- companies linked by special contracts in accordance with the Companies Act or if profits and losses are, or can be, transferred between them. Arm's Length Principle.

The Croatian TP legislation adheres to the arm's length principle for all intercompany transactions (regardless of whether they are domestic or cross-border, between companies, or between individuals).

Treatment of the OECD Guidelines

Croatian TA mainly adopted the OECD Guidelines within the published administrative circulars. In order to be consistent with the current OECD standards, the circulars are under revision from time to time.

Accepted TP methods and priority

When choosing the appropriate TP method, it is necessary to take the provisions of Article 13 Law on CIT Act and the OECD Guidelines into account.

In accordance with Article 13, Paragraph 2 of the CIT Act, for the establishment and assessment of whether the business transactions between the associated persons are agreed at market prices, the Croatian TA adopts the OECD Guidelines' methods. It should be noted that there is little specific guidance or description in the legislation about how these methods should be applied.

Taxpayers must have and must provide (by request of the Croatian TA) the data and information about the associated persons and their business relations with these persons, methods used for the determination of comparable market prices and their reasons for selection of particular methods.

According to the Law on Corporate Income Tax, CUP, RPM, and Cost Plus are the preferred TP methods, if the comparable arm's length data can be determined. These are to be qualified as fully comparable with the transaction under review after making appropriate adjustments with regard to the functions performed, risks assumed, and assets employed.

If such fully comparable arm's length data cannot be determined, limited comparable data shall be used after making appropriate adjustments under the application of an appropriate TP method also including TNMM and PSM.

Benchmarking

In the local environment (in Croatia), there is a list of requirements relating to inter-company transactions. Only after fulfilling such requirements, the price measurement methods from the OECD model may be used.

Documentation requirements

Croatia does not currently have formal TPD requirements. However, the Croatian Ordinance on Profit Tax Act, Article 40, provides the required list of activities which must be performed to determine whether a transaction is performed at a regular market price:

1. Identify a selected method and provide reasons why this specific method was selected.
2. Describe the examined data, methods, and analysis performed to determine transfer prices and explain why this specific method was selected.
3. Prepare documents on assumptions and assessments which were established in the course of determining the result using the unbiased transaction principle (indicate comparability, functional analysis, and risk analysis).
4. Prepare documents on all calculations made, applying the selected method relating to the taxpayer and comparable taxpayer.
5. Adequately update documents from previous years which were relied upon during the current year, to show adjustments caused by material changes in relevant facts and circumstances.
6. Prepare documents which state the background (basis) or are otherwise supportive or have been mentioned in the process of TP analysis.

Please note that the documentation does not need to be submitted with the tax return, but should be readily available in case of a request of the Croatian TA.

Tax audit procedure

The Croatian TAs usually examine the adequateness of intercompany TP during regular tax field audits. Tax audits typically cover periods of up to three consecutive fiscal years. In case of a tax audit, the taxpayer is generally obliged to cooperate with the tax auditors. TPD for all types of transactions must only be submitted upon request of the Croatian TAs.

Content of documentation

Although documentation is not required unless requested upon tax audit by Croatian TAs, it is recommended that documentation contains at least the information contained in the 6 points described above.

Documentation may be prepared in English, but documentation written in Croatian will have to be submitted to the Croatian TA in the case of an audit. If prepared in English, the Croatian TAs may require an official Croatian translation.

Statute of limitations

The tax audit deadline is generally three years following the year in which the relevant tax return is filed (i.e., four years from the end of the taxable period to which the documentation relates).

Immateriality threshold

The concept of immateriality (or a de minimis transaction) does not exist in the Croatian legislation.

Burden of proof

The burden of proof is placed on the taxpayer.

Tax return disclosure

The form of TPD is not predefined and guidelines have not been issued addressing the appropriate level of detail. So, judgment is required.

Income adjustment, surcharges, and penalties

a. Estimation of tax base

Possible at the discretion of the Croatian TA, if they conclude non-arm's length character of transaction or lack of TPD.

If the taxpayer:

- does not submit TPD, or
- the submitted documentation is substantially unusable, or
- it is determined that the taxpayer has not prepared the documentation contemporarily for extraordinary transactions,

then, it is disputably assumed that the domestic income of the taxpayer exceeds its declared income. In such case, tax authorities are entitled to estimate the domestic taxable income of the taxpayer. Thereby, it is permitted to make the income adjustment to the most unfavorable point of the arm's length range.

b. Surcharges and penalties

The Croatian legislation does not provide specific penalties for the violation of TP legislation or for not having the documentation described above. However, the risk may arise in the sense of TP adjustments (adjustments to taxpayers' profits by not recognising certain costs or challenging interest rates or the mark up on services that were not, in their opinion, charged on an arm's length basis) for the amount evaluated by the Croatian TA as being non-compliant with the TP policy. As a result of such a profit tax base increase, the taxpayer will be obliged to pay CIT for the adjusted amount at the rate of 9.41 percent, increased by late payment interest at the rate of 9.41 percent annually (each year it is changed according to decision of Ministry of Finance). Furthermore, a taxpayer shall be fined from HRK 2,000 to HRK 200,000 (approx €140 to €28,000) if he fails to assess his tax liability in accordance with the CIT Act after the expiry of the tax assessment period, or fails to pay the tax in the assessed amount and within the prescribed time limits.

Advance pricing agreements

According to para. 4.123 of the OECD Guidelines, an APA is an agreement that in advance of controlled transactions, determines an appropriate set of criteria (e. g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the TP for those transactions over a fixed period of time. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax authorities. So far, this is not introduced in the Croatian legislation or practice.

Ex post measures to prevent double taxation

Croatia has signed Tax Treaties with 58 countries.

In case of a TP-related income adjustment, the taxpayer could take two possible approaches to prevent double taxation:

- The taxpayer has the possibility to appeal against the TP-related income adjustment within the national appeal procedure.
- The taxpayer could apply for a MAP according to Art. 25 of the Model Treaty to prevent double taxation in case of a TP-related income adjustment. Within a MAP, the TAs of the involved countries consult each other to resolve disputes regarding the TP-related double taxation. If the involved TAs cannot agree upon a result, the taxpayer usually can apply for arbitration procedure. The formal regulations for filing and the procedure of a MAP are set out in the 'Administration Circular regarding Mutual Agreement Procedures and Arbitration Procedures' as of Jul 13, 2006.

10. Contact information

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Cyprus



Statutory rules/laws

- No specific TP legislation as of yet.
- Circular on Tax Treatment of Intra-Group Back-to-Back Financing Arrangements 2017 issued by the Finance Ministry, referred to as the “Circular”.
- Article 33 of the Income Tax Law 2002 (amended 2004) (the “Law”) refers to the arm’s length principle.

Definition of related party

Companies are considered to be related if they fall within the scope of Section 33 of the Cyprus Income Tax Code, which states that transactions between related parties should follow the arm’s length principle (as set out in Article 9 of the Model Treaty on Income and on Capital) and allows the Cyprus Tax Authorities (“CTA”) to adjust the reported profits in case the transfer prices differ from prices that would have been agreed between independent entities.

Treatment of the OECD Guidelines

Cyprus applies the OECD Guidelines and is on the OECD’s ‘White List only for Intra Group Back-to-Back Financing Transactions. For any other transactions, Cyprus follows the OECD arm’s length principle.

Accepted TP methods and priority

The CTA adopts the methods specified by the OECD Guidelines, without giving priority to any one method.

Documentation requirements

There is no defined deadline under the Circular; documentation must be submitted to the CTA by a person who has license to act as auditor of a company in Cyprus and who is required to carry an assurance control of the transfer pricing analysis. The language must be either English or Greek. With regards to BEPS Action 13, TPD legislation is expected within the next year.

The Circular states that the following are the minimum requirements for TPD:

- a description of the computation of equity allocation required to assume the risks;
- a description of the group and the inter-linkages between the functions performed by the entities participating in the controlled transactions and the rest of the group, together with a description of the value creation in the broad sense within the group by the entities participating in the transactions;
- the precise scope of the transactions analysed;
- a complete list of the searched potentially comparable transactions;

- a rejection matrix for rejected potentially comparable transactions together with justifications of such rejections;
- the final list of comparable transactions which have been selected and used to determine the arm's length price applied to the intra-group transaction(s) accurately delineated;
- a general description of market conditions;
- a list of all previous agreements on TP concluded with other countries in relation to the transactions in question;
- a list of all the previous agreements concluded with the entity/ies under analysis which are still in effect at the time of the submission of the request; and
- a projection of the income statements for the years covered by the request.

Tax audit procedure

The Cyprus tax process is one of self-assessment. Following the filing of a tax return, the CTA has six years from the end of the relevant tax year to raise an enquiry (12 years in the case of established fraud or wilful default). Enquiries can range from simple information requests to detailed technical challenges over treatments adopted in the tax return.

Any enquiries are often conducted between the taxpayer and the CTA by exchange of information via correspondence and meetings. Where agreement cannot be reached, litigation may be necessary.

A taxpayer may proactively request that the CTA review the company's 'open' tax years if the taxpayer requires a tax clearance certificate (e.g. upon commencement of voluntary liquidation).

For companies in a tax-loss position per the self-assessment return, the CTA is not restricted to the above mentioned six-year (or 12-year) period; however, outside of this period, any adjustments may only reduce or nullify a loss.

Income adjustment, surcharges, and penalties

In the case of an unfavourable tax audit which creates additional tax liability, this can be subject to fines and other penalties. In case a person violates the provisions of the Assessment and Collection of Taxes Law or the relevant Regulations or the Notifications or the Decrees, the Tax Commissioner can impose an administrative fine of up to 20,000 Euros depending on the level of the violation.

Advance pricing agreements

Applications for the issuance of tax rulings or an APA are subject to the provisions of the Circular for TP analysis.

Any use by taxpayers of APAs will be subject to the exchange of information rules set under the Directive on Administrative Cooperation.

Ex post measures to prevent double taxation

Cyprus has an extensive network of double tax treaties with many countries, a full list of which can be found on the Finance Ministry's website.

Intercompany financing

Cyprus applies TP rules for financing transactions, specifically for intra-group back-to-back finance. The Circular follows the OECD Guidelines.

Safe harbour provisions/exemptions for SMEs

When a Cypriot tax resident group financing a company, which pursues a purely intermediary activity, grants loans or advances to related companies, which are refinanced by loans or advances obtained from related companies, it is considered that, in view of the risks associated with the transactions analysed, for sake of simplification, the transactions are deemed to comply with the arm's length principle, if the company receives in relation to its controlled transactions under analysis, a minimum after tax return 2 percent on the assets.

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Czech Republic



Statutory rules/laws

a. Law

Section 23 par. 7 of the Income Tax Act No. 586/1992 Coll.

b. Other guidelines (not legally binding, but generally accepted and applied)

Guideline D-332, issued by the Ministry of Finance of the Czech Republic, ref. no.: 39/86 829/2009-393, Financial Bulletin 6/2010 dated December 1, 2010 – summary of the applicable approach and legislation of the transfer pricing methods (based on the OECD Guidelines);

Guideline D-333, issued by the Ministry of Finance of the Czech Republic, ref. no.: 39/86 838/2009-393, Financial Bulletin 6/2010, dated December 1, 2010 – summary of the rules of the advance pricing agreement;

Guideline D-334, issued by the Ministry of Finance of the Czech Republic, ref. no.: 39/86 849/2009-393, Financial Bulletin 6/2010, dated December 1, 2010 – summary of the standards of the document preparation and explanation of the scope and content of the Code of Conduct made by the EU Joint Transfer Pricing Forum;

Guideline D-10, issued by the General Financial Directorate of the Czech Republic, ref. no.: 37488/12 3131 13228, dated November 13, 2012, published on the websites of the General Financial Directorate of the Czech Republic – unified approach towards the evaluation of the low value intercompany services.

Definition of related party

The term “related party” is defined in section 23 par. 7 of the Income Tax Act No. 586/1992 Coll.:

a. Parties related through capital

- where one party directly participates in another party's capital or voting rights, or one party participates in the capital or voting rights of more parties and this person has a holding of at least 25 percent in the others' registered capital or voting rights, in such a case all are regarded as mutual related directly through capital,
- where one party indirectly participates in another party's capital or voting rights, or one party indirectly or directly participates in the capital or voting rights of more parties and has a holding of at least 25 percent in the others' voting rights, in such a case all are regarded as mutually related through capital.

b. Otherwise related parties

- where one party participates in the management or control of another party,
- where identical parties or close persons participate in the management or control of other parties and such other parties are otherwise related parties,

- involving controlling and controlled party and parties controlled by the same controlling party,
- being close persons,
- being parties that established a legal relationship predominantly for the purpose of reducing their tax base or increasing their tax loss.

Treatment of the OECD Guidelines

The abovementioned law, guidelines, and tax legislation are generally based on the OECD Guidelines and on the Code of Conduct made by the EU JTP Forum.

Accepted TP methods and priority

The Czech TA adopts the TP methods prescribed by the OECD Guidelines. Additionally, there is no priority among the methods. Should the result correspond with the arm's length principle, the tax inspectors cannot require the application of another method.

Documentation requirements

Companies have no legal obligation to prepare TPD, it is the sole decision of the taxpayer. However, it is preferred to have TPD during the tax audit in order to efficiently support the transfer prices/related transactions (since the burden of proof lies with the taxpayer) and to ease the task of the tax inspectors.

Based on the above, there are no formal deadlines on the preparation of the TPD, but it should be presented as evidence during the audit to confirm the applied prices. However, in case of a challenge by the Czech TA, it shall be generally submitted within 15 days after the request of the tax authority.

The preferred language is Czech, but in case of a preliminary request, other languages (mainly English) may be accepted.

There are no legally binding standards for TPD, but Guideline D-334 is generally accepted and applied. This Guideline recommends the presentation of the following:

- description of the business,
- functional analysis,
- terms and conditions of the transactions,
- industry analysis,
- applied TP method and the supporting data,
- description of the applied prices.

Tax audit procedure

In case of a tax audit, the likelihood for reviewing the transfer prices is significant. The “hot” topics are management fees, royalty payments, restructurings, and economic operation resulting in long-term losses.

Taxpayers are to be expected more and more audits since officials have required the tax inspectors to largely focus on the transfer prices and a separate tax department with TP experts has been established for professional audits.

Income adjustment, surcharges, and penalties

If a tax shortage regarding the difference between related and arm’s length prices is assessed, then the inspectors may modify the tax base and either 20 percent of the difference or 1 percent of the decreased tax loss will be levied as a penalty.

For late payments, the interest of the repo rate of the Czech National Bank plus 14 percent is applied.

Advance pricing agreements

- APA requests are available to taxpayers since 2006.
- The relevant rules and contents are found in Guideline 333.
- The fee of the request is 10,000 CZK (approximately €385).
- In case of an approval, the maximum period for the APA is 3 years.

Ex post measures to prevent double taxation

The Czech Republic has signed onto the MLI on 7th June 2017, and the country has 82 Tax Treaties in effect, according to the data published by the Ministry of Finance of the Czech Republic.

The MAP request – depending on the subject of the case – has to be filed to the Ministry of Finance or to the General Financial Directorate of the Financial Administration within the period defined in the relevant treaty.

Local administrative appeal procedures are also available for the taxpayers while roll-back APA does not apply.

Intercompany financing

There are no specific rules regarding the intercompany financing. However, it is generally expected from the taxpayer that the adequate arm’s length consideration for the financing services shall be determined according to the financial market and based on equal or similar financing services rendered under equal or similar circumstances (credit rating, duration, sum, etc.) as between unrelated parties.

Safe harbour provisions/exemptions for SMEs

No safe harbour rules exist in the Czech jurisdiction, and there are no exemptions neither for SMEs nor for another segment of taxpayers.

TP and PEs (AOA)

The Czech Republic does not apply AOA, and there is also no information whether an implementation in domestic law is planned in the future. However, application may be possible when particularly agreed in a specific double tax treaty.

The tax legislation generally allows only the “direct method” for allocating assets, free capital and profits.

Other topics

The Czech TA does not require the use of local comparables in a benchmarking study or comparative analysis, it uses the Amadeus database, and maintains its own internal comparables. The Czech TA focuses on the interquartile range in a TNMM analysis and it typically accepts comparables providing averaging results covering multiple years (three or five years).

A legislation was passed in the summer of 2017 to make CbCR and CbC exchange measures part of Czech law by applying OECD’s relating minimum standards. Companies that are part of a multinational group with a total consolidated turnover reaching €750 million have to notify the Czech TA about the reporting entity of the group. The first notification deadline is 31st October 2017 for the fiscal year 2016 (or the fiscal year ending before the deadline).

It is worth mentioning that from 2014, taxpayers have the duty to fill and file a separate enclosure together with the corporate income tax return on which the data of the related party transactions shall be indicated (volume, type, name, and registered seat of the related parties, etc.)

The general statute of limitations applies to TP, which is 3 years after the end of the period in which the tax return was due to be filed. However, should the tax inspectors levy a penalty, then the 3-year limit is restarted.

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France



Statutory rules/laws

- French Tax Code (CGI): articles 57 and 238 A (since the law of 1933)
- French Procedural Tax Code on compulsory fiscal documentations: articles L 13B, 188A, L 80 B 7 and 13 AA
- Tax Administration Official Bulletin (Bulletin Official des Impôts) dated February 18, 2014 on Tax Base, Profit Transfer
- The European Commission has created a workshop (businessmen and European Tax Administrations to set up a common documentation

Definition of related party

The related parties are dependent on each other, of which one is being located outside from France. The dependence could be legal or de facto:

- Legal: owning significant shares in the capital, voting power, the right to appoint the majority of members of management;
- De facto: contractual links (any contract or agreement between the two parties).

The FTA should give any evidence of the dependence links.

When a country is considered as a tax haven, the FTA may assume unfair tax pricing and is not required to prove the companies are related parties.

Treatment of the OECD Guidelines

The French tax administration's ("FTA's") position meets and refers explicitly to the OECD Guidelines.

The European Commission resumes the OECD references in an EU Directive in July 12, 2016 called "anti-tax evasion".

Accepted TP methods and priority

The FTA accepts the methods prescribed by the OECD Guidelines, with no priority among the accepted methods. However, the FTA prefers does the CUP Method as the article 57 of the French Tax code is based on this method.

Groups may also applied unspecified methods to evaluate intercompany transactions in the event that an unspecified method provided the most reliable measure of the arm's length price.

Lastly, whatever the method chosen, it should be compared with a transaction carried out by an independent company.

Documentation requirements

Since 2009, the FTA requires that large companies that meet the following criteria to set up documentation to justify their TP policy:

- The company or its ultimate parent company has a total of more than €400 million balance sheet total or revenues and belongs to a group: the company is then subject to compulsory TPD every year;
- The company has a balance sheet total of less than €400 million; in case of tax audit, it should remit the TPD to the FTA.

a. Filing deadline

The day when the tax audit starts or within 30 days after having summoned by tax administration.

b. Mandatory language

If the TPD is not written in French, the FTA may require its translation into French.

c. Alignment with new Ch. V of OECD Guidelines/BEPS Action 13

BEPS Action 13 was reported in the French law. For all the Fiscal Year starting January 1, 2016, all parent-companies must fill Form 2258-SD.

All the information to provide is detailed in the article 46 quarter-0 YE of CGI.

The form must be sent twelve months at least after the closing in a dematerialised way. If not, the company could pay up to €100,000.

Tax audit procedure

The FTA usually controls transactions based upon intangible properties, services, and intercompany transactions.

The tax auditor verifies the compliance of TP used by the company for purchases, sales, and/or any operation with the arm's length standard.

Although new documents are required since the Law of December 6, 2013, the tax auditor should get access to the analytical accounting and to the consolidated Financial Statements to get an overview of all the parents-subsidiaries.

The tax audit usually covers a three Fiscal years period. The tax audit period can be extended backwards until the point in time when the company had incurred tax losses which the company was able to carry forward.

Documentation should be provided to the FTA on the day the tax audit begins. If documentation is not available, the FTA will send an official request to be provided with the documentation with the next 30 days.

If the replies are not considered appropriate, the FTA may assess a fine for each fiscal year requested.

Income adjustment, surcharges, and penalties

a. Estimation of tax basis

In the course of a tax audit, in order to apply Art 57 of French Tax Code, the FTA must prove that:

- The companies involved are related parties (i.e. dependent on each other, one being located in France and on foreign);
- Profit is unfairly transferred to the foreign entity.

In such circumstances, the FTA may adjust the company tax base according to items which are specific to the audited operations while applying the accepted TP methods (Direct Assessment Method).

When specific information is missing, the tax base may be determined by comparison to companies operating normally (Accessory Assessment Method).

In case of a company failure to disclose TPD, FTA is entitled to assess the tax base according to available information (Direct Assessment Method). If such information is missing, the tax base is determined by comparison to companies operating normally (Accessory Assessment Method). The tax base adjustment will amount to the profit transferred abroad without pricing justification.

b. Surcharge and penalties

Providing TPD to the FTA is required by law. Failing to abide exposes companies to heavy penalties.

When proven by the FTA, unfair TP generally results in tax base reassessment, as well as in usual penalties for late payment, absence of or late declaration.

In addition, the TP adjustment made by the FTA will be considered as a profit distribution – such as dividends – and will be taxed accordingly.

Advance pricing agreements

France has instituted the administrative practice of entering into APAs. These agreements, which are voluntary and initiated by the French corporate taxpayer, will allow the French member of a corporate group to negotiate the modalities for determining its transfer prices for a three-year period on those categories of transactions that are submitted to the FTA for its prior review. A TP agreement (or APA) guarantees the taxpaying parties that their approved transfer prices will not be contested during the tax period covered by the agreement unless: (i) it was entered into on false pretenses; (ii) its terms are not followed by the private parties, or (iii) in cases of fraud.

Ex post measures to prevent double taxation

A TP control by one of the two local TAs can trigger double taxation.

The taxpayer has the opportunity to appeal against the TP-related income adjustment within the national appeal procedures. In this case, the local TAs should tend to figure out the issue with no obligation to get results.

The taxpayer could also apply for a MAP according to Art. 25 of the Model Treaty to prevent a double taxation in case of TP-related income adjustment. Within a MAP, TAs of the countries involved consult each other to resolve disputes regarding the TP-related double taxation. If the TAs involved cannot agree upon a result, the taxpayer can usually apply for the arbitration procedure.

The MAP was accepted by the FTA.

The taxpayer may follow both procedures (national appeal procedure and MAP) simultaneously. However, in practice, it is often more efficient to apply for one procedure after the other has been conducted.

Intercompany financing

In case of a foreign loan, the FTA compares the rate with the general rate that the French company could get with a stakeholder in France. Thus, there is no profit transfer if the rate exceeds the average one on the loaner market, if it is lower than the French average rate.

Inside company groups, the French court has not arbitrated yet.

The loan has to be analysed at date when the agreement is signed off and later in any favourable terms negotiation for the lender.

Safe harbour provisions/exemptions for SMEs

According to the article 233 quinquies of CGI (French Tax Code), French companies must declare documentation related to TP. The SMEs have simple form to declare.

The SMEs are the companies which the following thresholds:

- The revenues or the gross asset should be up to €50 million; or
- They directly or indirectly own at least 50 percent of the voting power or the capital shares of a legal entity which meets the first threshold; or
- They are held by an entity which meets the first threshold; or
- They belong to a tax group with at least one company meets the first threshold.

Companies should provide the form six months at least after the annual tax return (beginning of November Y+1 when the company closes its fiscal year in December).

TP and PEs (AOA)

Companies which have business in many countries through PEs must provide the tax return to the FTA.

When the head office is abroad, the PE tax profit is based upon the revenues and the expenses applied directly.

There is no possibility to allocate the tax profits of the company to the PE as OECD allows it.

Contact information

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Germany



Statutory rules/laws

a. Law

- Sec. 1 Foreign Tax Act (“FTA”);
- Sec. 4 para. 1 Income Tax Act (“ITA”);
- Sec. 8 para. 3 Corporate Income Tax Act (“CITA”);
- Sec. 90 para. 3, Sec. 138a, Sec. 162 para. 3 and 4, Sec. 175a, Sec. 178a, Sec. 379 General Fiscal Code (“GFC”).

b. Statutory ordinances

- Documentation of Profit Allocation as of Nov 13, 2003 (Gewinnaufzeichnungsverordnung – “GAufzV”), last revision on July 12, 2017;
- Cross-Border Transfer of Functions as of Aug 12, 2008 (Funktionsverlagerungsverordnung – “FVerlV”);
- Ordinance on the application of the arm’s length principle to permanent establishments pursuant to sec. 1 para. 5 FTA as of October 13, 2014 (Betriebsstättengewinnaufteilungsverordnung – “BsGaV”).

c. Selection of important administrative circulars

- Principles relating to the Examination of Income Allocation Between Internationally Affiliated Enterprises (“Administration Principles”) as of Feb 23, 1983;
- Principles relating to the Examination of Income Allocation for PEs of Internationally Operating Enterprises as of Dec 24, 1999, last revision on Aug 25, 2009 (“Administration Principles – PE”);
- Principles relating to the Examination of Income Allocation by Cost Sharing Agreements Between Internationally Affiliated Enterprises as of Dec 30, 1999;
- Principles relating to the Examination of Income Allocation Between Internationally Affiliated Enterprises in Case of Secondments as of Nov 9, 2001;
- Principles for the Audit of Income Allocation Between Affiliated Parties with Cross-Border Business Relations in Respect of the Duty of Determination, the Duty of Cooperation, Adjustments, Mutual Agreement Procedures, and EU Arbitration Procedures as of Apr 12, 2005 (“Administration Principles – Procedures”);
- Memorandum on international mutual agreement and arbitration procedures in the field of taxes on income and capital as of Jul 13, 2006;
- Memorandum on bilateral or multilateral APAs as of Oct 5, 2006;
- Principles relating to the Examination of Income Allocation Between Related Parties in case of Cross-Border Transfer of Functions as of Oct 13, 2010 (“Administration Principles on Transfer of Functions”);

- Principles for the Application of Sec. 1 FTA to Cases of Marginal Amortisations and other Depreciations on Loans Issued to Foreign Related Entities as of Mar 29, 2011;
- Administrative Principles regarding the Income Allocation between an enterprise and its permanent establishment as of Dec 22, 2016;
- Memorandum on coordinated tax audits with tax administrations of other states and territories as of Jan 06, 2017;
- Principles relating to the Use of a Brand name within a Group as of Apr 07, 2017.

Definition of related party

The term “related party” is defined in sec. 1 para. 2 of the FTA. According to this provision, a person is to be qualified as related to a German taxpayer, if:

- such a person holds, directly or indirectly, a participation of at least 25 percent in a taxpayer’s capital (substantial participation), or if such a person is able to exercise, directly or indirectly, a controlling influence or vice versa, if the taxpayer holds a substantial participation in such person’s capital or is able to exercise, directly or indirectly, a controlling influence on such person; or
- a third person holds a substantial participation in both such persons’ capital and the taxpayers’ capital or is able to exercise, directly or indirectly, a controlling influence on both of them; or
- such a person and the taxpayer are able, in agreeing on the terms and conditions of a business relationship, to exercise influence on the taxpayer or on the person based on facts beyond such business relationship, or if one of them is personally interested in the other party’s income.

Treatment of the OECD Guidelines

The German tax authorities (“GTA”) adopted the OECD Guidelines within the published administrative circulars to a large extent. The circulars are under revision from time to time, to be consistent with the current OECD standards.

Accepted TP methods and priority

The German regulations adopt the TP methods prescribed by the OECD Guidelines. According to FTA sec. 1 para. 3 sent. 1, the CUP Method, RPM, and Cost Plus Method are the preferred TP methods if comparable arm’s length data can be determined, which are to be qualified as fully comparable with the transaction under review after making appropriate adjustments with regard to the functions performed, risks assumed, and assets employed.

If such fully comparable arm’s length data cannot be determined, limited comparable data shall be used after making appropriate adjustments under the application of an appropriate TP method, including also the TNMM and the PSM (FTA sec. 1 para. 3 sent. 2).

In the case that no (fully or limited comparable) arm’s length data can be determined, the taxpayer is obliged to perform a so called ‘hypothetical arm’s length test’. For this purpose, the taxpayer is obliged to determine a hypothetical minimum price of the supplier and a hypothetical maximum price of the recipient, based on a functional analysis and internal planning data.

Minimum and maximum prices frame the so called range of mutual consent, which is determined by the capitalised profit potentials of the transferred asset under review. If the taxpayer cannot credibly show that another price complies with the arm's length principle, the mean value of the so called range of mutual consent should be regarded as the relevant transfer price.

In practice, the hypothetical arm's length test often applies for intercompany transfer of intangible assets or in case of the cross border transfer of functions. Due to the German regulations, the determination of a transfer price for the transfer of a function has to consider the transfer package as a whole (including all tangible and intangible assets as well as all other advantages related to the transferred function).

Documentation requirements

Implementation of the OECD's three tier approach

In 2016, Germany has adjusted its TPD rules to the recommendations of the BEPS Project and implemented a three-tier approach, including a Master File, Local File, and CbCR.

The documentation shall include the type, contents, and scope of the cross border transaction with related parties, including the economic and legal basis for an arm's length determination of prices and other business conditions. The content of the Master File and the Local File is settled in GFC sec. 90 para. 3 and in GAufzV; and the content of the CbCR is settled in GFC sec. 138a. The German TPD requirements are outlined in detail in the GAufzV and Administration Principles – Procedures as of Apr 12, 2005.

The three-tier approach only applies if the corresponding requirements are fulfilled. The following table shows the requirements that have to be met to be obliged to prepare the corresponding documentation:

| Master File | Local File | CbCR |
|--|---|---|
| <ul style="list-style-type: none"> Enterprise belongs to a multinational group (= a German enterprise and at least one foreign related party or a permanent establishment located abroad); and Turnover of the enterprise is at least EUR 100 m in the previous fiscal year. | <ul style="list-style-type: none"> German enterprise maintains business relations with a foreign related enterprise or a permanent establishment located abroad. | <ul style="list-style-type: none"> At least one foreign enterprise or permanent establishment located abroad is included in the German consolidated financial statement; and Consolidated revenues of the consolidated financial statement of the previous fiscal year amounts to at least €750m. |

a. Filing deadline

If the abovementioned conditions are met for business years commencing after December 31, 2016, the taxpayer must prepare a Local File and a Master File.

Master File and Local File only need to be provided upon German TA's request. However, in case of extraordinary business transactions (e.g. restructurings, cost sharing, other material long-term agreements), documentation needs to be prepared within six months after the end of the business year in which the business transaction occurred.

Usually, in preparation of a tax audit, the German TA requests the TPD. Upon request by the tax auditor, the documents must be furnished within 60 days of the request or, in case of extraordinary business transactions, within 30 days.

A CbCR is to be submitted for business years commencing after December 31, 2015, and it must be submitted within one year after the end of the respective business year.

b. Mandatory language

According to GAufzV sec. 2 para. 5, TPD must be prepared in German. However, upon application of the taxpayer, the German TA may accept exceptions hereof. In practice, taxpayers mostly prepare TPD in English and provide translations upon the German TA's request.

Tax audit procedure

The German TA usually examines the adequateness of intercompany TP only during the regular tax field audits, which typically cover periods from three to five consecutive fiscal years. In case of a tax audit, the taxpayer is generally obliged to cooperate with the tax auditors.

In case of MNEs, the examination of the cross-border transfer prices is increasingly the focus of the German TA. However, TPD for all types of transactions must only be submitted upon request of the German TA. The time limit for the presentation is 60 days following the request (respectively, 30 days in case of extraordinary transactions). Extensions are only granted for special reasons.

The tax auditors are not authorised to issue revised assessments for the years under review. The final audit report, including suggestions for any tax adjustments, is presented to the local tax office where the revised tax assessments are to be prepared. The local tax office usually follows the recommendations of the tax auditors. If the taxpayer does not agree with the revised assessments, he/she has the possibility to apply for an appeal procedure as described below.

Income adjustment, surcharges, and penalties

a. Estimation of tax base

If:

- the taxpayer does not submit TPD, or
- the submitted documentation is substantially unusable, or
- it is determined that the taxpayer has not prepared the documentation contemporarily for extraordinary transactions,

it is disputably assumed that the domestic income of the taxpayer exceeds its declared income. In such case, the German TA is entitled to estimate the domestic taxable income of the taxpayer. Thereby, it is permitted to make the income adjustment to the most unfavorable point of the arm's length range.

b. Surcharges and penalties

If:

- the taxpayer does not submit TPD, or
- the submitted documentation is substantially unusable, a penalty of 5 percent to 10 percent of the income adjustment shall be assessed, with a minimum surcharge of €5,000.

In case of delayed submission, the surcharge may be up to €1 million, or at least €100 for each full day by which the deadline has been exceeded.

With respect to the above described regulations, TPD is to be regarded as “substantially unusable” if the documentation does not enable a third person expert to determine within a reasonable period of time which facts the taxpayer has realised with regard to his/her business relations with related parties and whether and to what extent the taxpayer has complied with the arm’s length principle.

Advance pricing agreements

According to para. 4.134 of the OECD Guidelines, an APA is an agreement that determines, in advance of controlled transactions, an appropriate set of criteria (e. g. method, comparables, and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the TP for those transactions over a fixed period of time. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more TAs.

As a rule, the German TA only grants bilateral or multilateral APAs. Unilateral advanced rulings for TP issues with binding effect are not provided for German taxpayers. In general, APAs are welcomed and supported actively by the German TA. The Federal Central Tax Office, located in Bonn, carries out the APA procedure as the German CA. Usually, the local tax office and tax auditor are involved in the APA procedure. The formal regulations for the filing and procedure of an APA are set out in the APA-Guidelines (Administration Circular as of Oct 5, 2006).

According to GFC sec. 178a, APA procedures are subject to a filing fee in Germany. The basic fee for each APA application amounts to €20,000 per country involved. The extension fee for an already existing APA amounts to €15,000. The amendment fee for amendments during a current APA procedure amounts to €10,000. In case of small enterprises, a reduction of the APA filing fees are possible.

Ex post measures to prevent double taxation

In case of a TP-related income adjustment, the taxpayer could take two possible approaches to prevent double taxation:

- Firstly, the taxpayer has the possibility to appeal against the TP-related income adjustment within the national appeal procedure. Thereby, the taxpayer has to appeal against the revised assessments by the regional tax office. If the appeal’s department denies the appeal, the taxpayer has the possibility to take court’s action against the decision. The proceeding would be heard first by regional tax court; if admitted, then by the Federal Tax Court.

- Secondly, the taxpayer could apply for MAP according to Art. 25 of the Model Treaty to prevent a double taxation in case of TP related income adjustment. Within a MAP, the TAs of the involved countries consult each other to resolve disputes regarding the TP related double taxation. If the involved TAs cannot agree upon a result, the taxpayer usually can apply for an arbitration procedure. The formal regulations for the filing and procedure of a MAP are set out in the Administration Circular regarding MAPs and Arbitration Procedures as of July 13, 2006.

Germany has signed the MLI and has opted for a compulsory binding arbitration procedure (MLI Articles 18 & 19). However, this is only applicable to the Tax Treaties covered by the MLI if the other contracting country has also opted for it. MLI Article 19 provides for the introduction of an arbitration clause. An arbitration procedure is to be made binding upon the request of the taxpayer if the MAP was unsuccessful two years after the start of the period. However, Germany has opted for a longer period of proceedings for MAP, so that an arbitration procedure can be initiated only after three years instead of two years. However, the MLI has not yet been implemented into national German law.

Besides, within the EU, there is the possibility to apply for the EU Convention regarding TP related double taxation.

The taxpayer can follow both approaches (national appeal procedure and MAP) contemporaneously. However, in practice, it is often more efficient, to follow the approaches one after another.

Intercompany financing

In Germany, there are no specific TP regulations relevant to loan and guarantee transactions.

Determination of debt v. equity

In Germany, in particular, the following criteria are applied in determination of debt or equity:

- Treatment of the capital in case of insolvency or liquidation;
- Duration of the capital transfer;
- Type of remuneration;
- Loss participation.

Arm's length interest rate

The German TA does not specify methods for determining the arm's length interest rate.

Deductibility of interest

The Annual net interest expense as excess of interest paid over that received of a company is only deductible at up to 30 percent of EBITDA for corporation and trade tax purposes. The 30 percent limitation applies to all interest, whether the debt is granted by a shareholder, related party, or a third party.

There are certain exemptions to this limitation, which does not apply where:

- the total net interest expense for the year is less than €3 million, or
- the company does not belong or only proportionally belongs to a group, or

- the net amount paid to any one shareholder of more than 25 percent (or a related party) is no more than 10 percent of the total amount paid. However, in this case, the equity-to-gross assets ratio of the company must be no more than 2 percent below that of the group as a whole.

Unused EBITDA potential may be carried forward for up to five years to cover future excess interest cost. This carryforward is otherwise subject to the same principles as the loss carryforward, including curtailment on change of shareholder(s).

In a decision as of October 14, 2015, the Federal Fiscal Court has held the interest limitation to be in breach of the constitution and has asked the Constitutional Court to give a definitive ruling. Since the Federal Fiscal Court is of the view that the provision is unconstitutional, it has suspended the proceedings in a pending case and submitted the question to the Constitutional Court.

It is emphasised that the interest limitation is additional to, and not a substitute for, the TP requirement that related-party finance be at arm's length.

Loan write off treatment

The German TA also applies the arm's length principle on marginal amortisation and other depreciations on loans between related parties. According to the German TA, a marginal amortisation or depreciation on loans can only be written down with tax effect if a third party creditor would have granted the loan or allowed it to remain outstanding in otherwise similar circumstances.

In this regard, the German TA applies the Principles for the Application of FTA Sec. 1 to 'Cases of Marginal Amortisations and other Depreciations on Loans Issued to Foreign Related Entities as of March 29, 2011.

However, according to the German jurisdiction, the dealing at arm's length principle should not be applied on loan depreciation.

Safe harbour provisions/exemptions for SMEs

Low-value adding intragroup services

As stated above, German TA is updating the administrative principles on a regular basis to be in line with the OECD Guidelines. According to para. 7.43 of the OECD Guidelines, a simplified determination of arm's length charges can be applied on low value adding intragroup services. The mark-up shall amount to 5 percent of the relevant cost, and does not need to be justified by a benchmarking study.

Also, according to the report on low value adding services of the EU JTP Forum, a markup of 3 percent to 10 percent, and often 5 percent should be regarded as arm's length.

Exemption from preparing a full TPD

Taxpayers which are to be qualified as small enterprises are exempt from the obligation to prepare a full TPD, according to the provisions of GAufzV. In this respect, a small enterprise is an enterprise for which neither the sum of €6 million regarding the remuneration for the supply of goods or commodities from business relations with related parties nor the sum of €600,000 for remuneration of other services for business relations with related parties is exceeded in the current business year.

TP and PEs (AOA)

In 2013, the German TA implemented the AOA in national law in FTA sec. 1 para. 5. Under the AOA, the arm's length principle must be applied to the cross-border profit allocation between a PE and the enterprise of which it is a part. Therefore, for determining arm's length transfer prices for the transactions with other parts of the enterprise, the PE is regarded as a separate and independent enterprise.

Other topics

Reallocation of functions

In 2008, Germany introduced a new sec. 1 para. 3 sent. 9 and 10 in the FTA. The scope of this provision is the transfer of whole business functions from Germany to another country. In the case a whole business function is transferred, an evaluation and taxation of a transfer package is necessary. To ease taxation in Germany, a transfer of a function is necessary. A transfer of a function is given if an enterprise (the transferring enterprise) conveys assets and other benefits to a different, related enterprise (the receiving enterprise) together with the associated opportunities and risks, or provides these for use by the receiving enterprise, so that the receiving enterprise can exercise a function that was previously exercised by the transferring enterprise, thereby restricting the transferring enterprise's exercise of the function in question. Therefore, a taxation should be not triggered if there is no restriction. This case occurs for example, if a totally new function is exercised within a group or a function is duplicated.

Controlled foreign company ("CFC") legislation

The German TA introduced the CFC legislation in 1972. Germany operates a CFC regime aimed at passive income sheltered abroad and taxed at less than 25 percent. Essentially, such income is added to that income taxable in Germany in the regular manner against a credit for the foreign tax actually paid and not recoverable by either the foreign entity or its shareholder. Active business income is generally exempt from the CFC provision, provided it is earned through a properly established facility of a scale appropriate to the activity concerned.

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Greece



Statutory rules/laws

- Law 4172/2013 and Law 4174/2013 determine the TP regulatory framework in Greece (“Greek TP Regulations”).

The TP obligation covers transactions carried out between legal entities or any other form of entity with associated persons. In particular, according to the provisions of article 50 of Law 4172/2013, when legal entities or any other form of entities carry out transactions, one or more, international or with local entities, with associated persons under economic terms different than those that would have been agreed between independent persons or between associated persons and third parties, then the profits that would have been derived by the legal entity or any other form of entity and which have not been derived due to the application of different terms (arm’s length principle) are included in the profits of the legal entity or any other form of entity only to the extent that they do not reduce the amount of payable taxes.

Definition of related party

The term “related party” or “associated person” refers to any person that participates directly or indirectly in the management, control or capital of the other person which is a family person or an associated person. Specific cases of association are provided in article 2(ζ) of Law 4172/2013.

Treatment of the OECD Guidelines

According to the Ministerial Circular Pol 1097/2014 (as amended by Ministerial Circular Pol 1144/2014) as well as according to Article 50 of Law 4172/2013, TP provisions apply and are interpreted according to the OECD Guidelines.

Accepted TP methods and priority

The TP methods to be used are determined by virtue of Ministerial Circular Pol 1097/2014, as amended by Ministerial Circular Pol 1144/2014. These are the TP methods outlined in Chapter II of the OECD Guidelines.

Where the application of the TP method and the use of comparables lead to a range of profits or prices, a narrowing of the range shall be performed by excluding 25 percent of the lowest and 25 percent of the highest values (i.e., the interquartile range).

In such a case, any price between the lower and the upper quartile will be considered to be compatible with the arm’s length price.

Most TAs acknowledge the use of the CUP Method, and, if applicable, it should be used as the preferred method. Although not specifically mentioned in the Greek legislation, the applicability and use of the CUP Method should be based on the principles from the OECD Guidelines.

In cases where there is insufficient or no data for the use of the traditional methods, taxpayers may use the transactional profit methods provided that justification for their selection is included in the TPD.

Documentation requirements

The TPD requirements are included in article 21 of Law 4174/2013. In particular:

- For each tax year, a TPD supporting the appropriate TP method must be prepared for the transactions both with domestic and foreign affiliated entities and a Summary Information Table (“SIT”) must be submitted electronically to the CAs (both within 6 months from year-end). PEs of foreign enterprises in Greece must also maintain a TPD covering transactions with the head office or with the associated persons of their head office abroad.
- The obligations apply to all intercompany transactions with one or more associated persons, unless the value of all transactions does not exceed €100,000 in total, where the gross revenues of the financial year of the taxpayer does not exceed €5,000,000, or €200,000 where the gross revenues of the financial year for the taxpayer exceed the amount of €5,000,000.
- The TPD for intra-group transactions consists of two parts, the “basic documentation” file and the “Greek documentation” file, which is complementary to the basic file and contains additional information. The basic documentation file -in case of a group- is common for all the companies within the group and contains common standard information for the liable legal entity, its PEs, and its affiliate companies. The Greek documentation file provides evidence for the liable legal entity and for the transactions which have to be documented.
- According to Ministerial Circular Pol 1097/2014, as amended by Ministerial Circular Pol 1144/2014, in the case of foreign group entities, the sections of the TPD may be written in an internationally acceptable language, preferably in English, with the obligation to translate into Greek within 30 days after a request by the Greek TA. The section of the TPD that refers to the Greek entity’s information, as well as the financial analysis of the intercompany transactions should be in Greek.

In addition, Law 4484/2017 implements EU Council Directive 2016/881 into Greek law and provides for CbCR and the mandatory automatic exchange of information in the field of taxation. In particular, there are requirements for certain multinational groups to file CbCR and the relevant legislation sets forth the information to be provided in a CbCR. The date for filing the first CbCR is 12 months of the last day of the reporting fiscal year (that is, for calendar year taxpayers, for 2016, the due date of the CbCR is December 31, 2017).

More specifically:

MNE groups operating in Greece with consolidated annual revenues exceeding €750 million in the preceding fiscal year of the year to be reported are subject to the new CbCR requirements and the ultimate parent company of such MNE groups should proceed with the respective filing.

The CbCR should provide aggregated tax information for each jurisdiction in which the MNE operates. This includes information relating to the global allocation of income, the taxes paid, and certain indicators of the locations of economic activity. The report should include a listing of all countries where the MNE group is active specifying the nature of the main business carried out by each entity. The CbCR is filed by the ultimate parent company of every liable MNE Group that has its tax residence in Greece.

The new requirements are in line with BEPS Action 13. In certain cases, Greek group companies belonging to MNEs without a Greek-resident ultimate parent may also be obliged to submit the CbCR. This extension applies in any of the following situations:

- The ultimate parent company of the group is not obliged to file a CbCR in its jurisdiction of tax residence;
- The ultimate parent entity's tax jurisdiction has not entered into an information exchange agreement with Greece on CbCR;
- The ultimate parent entity of the MNE group is obliged to file a CbCR in the jurisdiction of its tax residence and there is an agreement in force with Greece that allows the automatic exchange of CbCR, but such automatic exchange has been suspended or there is a persistent failure to automatically exchange CbCR.

The CbCR, together with the TPD, represents a standardised approach to TPD and will provide the Greek TA with information that would allow for efficient TP risk analysis. The information contained in the CbCR will be used in order to assess high-level TP risk and other BEPS-related risks. With these new obligations, it is anticipated that there will be an increase to the number of tax audits carried out by the Greek TA.

Tax audit procedure

TPD is usually audited by the Greek TA in the context of a full/regular tax audit, which is carried out at the end of the tax year. During a full/regular tax audit, all taxes that are applicable to the audited company are examined (e.g. income tax, withholding taxes, VAT etc.). The full/regular tax audit is definitive. Once a full/regular tax audit has been completed, the Greek TA cannot re-open the audited period, unless a new fact emerges. For large enterprises the CA is the Tax Office of Large Incorporations.

Furthermore, entities having the legal form of Anonymos Eteria ("AE"), Eteria Periorismenis Efthynis ("EPE"), and branches of foreign entities, which satisfy specific criteria, will have their TPD audited by certified auditors for the issuance of the Annual Tax Certificate.

Moreover, a Greek company may be obliged to have a statutory audit carried out by a certified auditor. In such case, a sample of companies audited by a certified auditor are further audited by the Greek TA. Apart from the companies selected for audit based on the said sample, regular audits can also be carried out, based on specific criteria set by the audit authorities (eg. if a large VAT or CIT refund is requested or fictitious records are identified).

Companies not required to be tax audited by their certified auditor may be audited by the Greek TA. The statute of limitation for tax audits carried out by the Greek TA is generally 5 years following the fiscal year in which the relevant income tax return should have been filed (this time limit may be extended to 20 years in case a tax evasion case can be established).

In all cases, the TPD should be made available to the Greek TA within 30 days of request.

Income adjustment, surcharges, and penalties

Adjustment

In general, the results of an unfavourable tax audit (i.e. where intercompany transactions are considered not to comply with the arm's length principle) are the following: a) profits will be included in the taxable profits of the audited company and relevant expenses will not be recognised as deductible for CIT purposes at the level of the audited company.

Penalties for failure to comply with filing obligations related to the summary information table and the TPD:

- Penalties for late filing of the SIT will be calculated at 0.1 percent on the value of the transactions subject to documentation requirements with a minimum penalty of €500 and a maximum penalty of EUR 2,000.
- Penalties for an inaccurate filing of the SIT will be calculated at 0.1 percent on the value of the amounts to which the inaccuracy relates with a minimum penalty of €500 and a maximum penalty of €2,000, unless the inaccuracy of the amounts does not exceed 10 percent of the value of the total transactions subject to documentation (in such case no penalty applies).
- Penalties for non-filing of the SIT will be calculated at 0.1 percent on the value of the transactions subject to documentation requirements with a minimum penalty of €2,500 and a maximum penalty of €10,000.
- In the case of filing an amended SIT, a penalty applies only to the extent that the amounts are amended and such amendments exceed the amount of €200,000. In the case that the amended amounts exceed €200,000, then the penalty is calculated at 0.1 percent on the value of the transactions subject to documentation requirements with a minimum penalty of €500 and a maximum penalty of €2,000.
- In the case of failure to provide the Greek TA with TPD within 30 days from the official request, a penalty of €5,000 applies, which is increased to €10,000 if TPD is provided after 60 days, and to €20,000 if it is provided after 90 days or it is not provided at all.
- For repetition within five years of the first infringement, the penalty equals double the initial penalty.
- For second repetition within five years from the first, the penalty equals quadruple the initial penalty.

Advance pricing agreements (APAs)

A Greek taxpayer/company can apply to obtain an APA for TP purposes. APAs can be unilateral, bilateral, or multilateral. APAs govern the TP methodology of specific future cross-border intra-group transactions for a period not exceeding 4 years (i.e. starting from the year when respective application is filed). An APA can, under conditions, be amended, either by the Greek TA or by its beneficiary, while the Greek TA can, in certain circumstances, revoke or cancel an APA.

Ex post measures to prevent double taxation

Greece has signed the MLI. Greece has generally taken a mainstream approach by adopting minimum standard provisions to combat treaty abuse and to improve the efficiency of cross-border dispute resolution, while notifying of the intention to apply the MLI provisions with respect to all Tax Treaties currently in force with other OECD member states. On the other hand, Greece has opted out of the provisions concerning Hybrid mismatches (art. 3-5) and the artificial avoidance of PE status (art. 12-15).

Greek tax legislation has also included a provision concerning MAP (article 63A of Law 4174/2013). Given that this provision is rather generic, a relevant decision (Ministerial Circular Pol 1049/2017) was recently issued by the Director of the Independent Public Revenue Authority providing guidance on the application of MAP in all Tax Treaties signed by Greece (specifying procedures, time frames, documentation to be submitted, information to be included in such documentation, etc.).

Furthermore, Greece has chosen to apply PART VI of the MLI on Mandatory Binding Arbitration (“MBA”). Greece reserved the right to set a three-year period limit for a MAP, following which a taxpayer may request initiation of the MBA mechanism, instead of the two-year period provided for in article 19 par.1 b of the MLI.

Intercompany financing

Deductibility of interest

Interest expenses from an intercompany loan generally qualify as deductible for CIT purposes, provided that the general deductibility conditions of Law 4172/2013 are fulfilled.

Arm's length interest rate

Interest expenses deriving from intercompany loans should be at arm's length in order to qualify for income tax deduction at the level of the borrower. In the process of setting an arm's length interest rate, market comparable interest rates (for loans on similar terms) should be taken into consideration.

Determination of debt v. equity

Notwithstanding the fulfillment of the general deductibility conditions of Law 4172/2013, a Greek company's interest expenses will not qualify as deductible to the extent that any IES exceeds 30 percent of the company's taxable profits before interest, taxes, depreciation, amortisation (EBITDA). This restriction does not apply (i.e. entailing that interest expenses are fully deductible) provided that interest expenses recorded in the company's accounting books do not exceed €3 million.

Loan write off treatment

Generally, an intercompany loan written off is considered income to the borrower.

Exemptions for SMEs

Law 4174/2013 provides that a simplified procedure and some exceptions shall apply to SMEs, which shall be defined and specified by virtue of a decision of the Secretary General. Currently, such decision has not yet been issued.

TP and PEs (AOA)

Under Greek legislation, the notion of "attribution of profits to PEs" is to a great extent identical to the notion of "determining the gross and net income of a PE". As the rules for the determination of the gross and net income of the PE are the same that apply to domestic enterprises, there has been no need for a particular elaboration in the context of a PE. In general, Greece applies in practice the AOA (although the AOA is not explicitly provided by Greek legislation).

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Hungary



Statutory rules/laws

a. Law

- Act. LXXXI. of 1996 on Corporate and Dividend Tax (“CITA”) – including: Definition of related party, Arm’s length principle, TP methods, and Documentation obligation;
- Decree No. 22/2009. (X.16.) of the Ministry of Finance (“MF Decree”) – including: Documentation requirements applicable for fiscal years starting before January 1, 2018;
- Decree No. 32/2017. (X.18.) of the Ministry for National Economy (“MNE Decree”) – including: New documentation requirements applicable for fiscal years starting on or after January 1, 2018;
- Act XCII. of 2003 on the Rules of Taxation¹ – including: APA, penalties;
- Decree No. 38/2006. (XII.25.) of the Ministry of Finance – including: The rules of APA procedure.

b. Other

Explanations of the Hungarian TA – they are not legally binding, but generally accepted and applied.

Definition of related party

The term “related party” is defined in section 4 point 23 of the CITA, as follows:

- the taxpayer and the person in which the taxpayer has a majority control – whether directly or indirectly – according to the provisions of the Civil Code,
- the taxpayer and the person that has majority control in the taxpayer – whether directly or indirectly – according to the provisions of the Civil Code,
- the taxpayer and another person if a third party has majority control in both the taxpayer and such other person – whether directly or indirectly – according to the provisions of the Civil Code, where any close relative holding a majority control in the taxpayer and the other person shall be recognised as third parties;
- a nonresident entrepreneur and its domestic place of business and the business establishments of the nonresident entrepreneur, furthermore, the domestic place of business of a nonresident entrepreneur and the person who maintains the relationship defined under Paragraphs a)-c) with the nonresident entrepreneur;
- the taxpayer and its foreign branch, and the taxpayer’s foreign branch and the person who maintains the relationship defined under Paragraphs a)-c) with the taxpayer;

¹Act XCII. of 2003 is expected to be replaced by a new act as of January 1, 2018, but at the time of preparing this guidance, the new act is not passed yet.

- the taxpayer and other person if between them dominating influence is exercised relating to business and financial policy having regard to the equivalence of management (new definition applicable as of 1st January 2015).

Majority control shall mean:

- voting rights exceeding 50 percent or
- the right to appoint/recall the majority of the management or supervisory board or
- an agreement concluded with other member(s)/shareholder(s) which results controlling of more than 50 percent of the voting rights.

Treatment of the OECD Guidelines

The abovementioned law, guidelines, and tax legislation are generally based on the OECD Guidelines and on the Code of Conduct made by the EU JTP Forum.

Accepted TP methods and priority

Generally, the Hungarian TA accepts the methods specified by the OECD Guidelines. There is no priority among the methods, however in practice CUP method prevails if applicable. "Other method" shall be chosen only in case if none of the OECD methods is applicable.

Documentation requirements

Hungary has released new BEPS compliant documentation rules (the above referred MNE decree) on October 18, 2017 (applicable for fiscal years starting on or after January 1, 2018), which contain significantly more extensive requirements than the MF decree recently in force.

a. Recent requirements (for fiscal years starting before January 1, 2018)

The MF decree recognises the following types of TPD:

1. Standalone documentation (with similar content requirements as a Local File has), which is generally applicable.
2. EU TPD (Master File + Local File concept), which is an option for the taxpayers.
3. Simplified documentation which is applicable solely for low valued added services.

The documentation shall be prepared per transaction type, on a yearly basis until the date of filing the CIT return. The deadline to file the CIT return is 5 calendar months after the closing date of the fiscal year. The application of the EU TPD concept shall be pointed out in the CIT return. The documentation is expected to be provided in Hungarian but English, German and French language materials shall also be accepted (however, translation might be required).

As of 1st January 2015, the MF Decree includes the obligatory application of the interquartile range to determine the arm's length profit in certain cases.

Intra-group services have to meet several criteria in order to be considered as low value added.

In practice, a comprehensive benchmarking study is required for all transactions/transaction types subject of the documentation (except low value-added services).

b. Future requirements (for fiscal years starting on or after January 1, 2018)

The most important change of the future legislation is that the MNE decree (replacing the above detailed MF decree) prescribes an obligatory application of the Master File + Local File concept for all taxpayers concerned. The content requirements for both the Master File and the Local File has been strongly extended (according to BEPS Action 13) while some additional rules for benchmarking/economic analysis has also been set forth.

The Master File, among others shall contain the following relevant information:

- The legal and shareholder structure of the group.
- The business activity of the group (supply chain; top products/services; subject and pricing of intra-group services; group-level functional analysis involving all members; restructurings, mergers and acquisitions).
- The intangibles of the group (R&D activities; owners of the intangibles; related party agreements involving intangibles).
- The financing structure of the group (group financing policies; relevant financing agreements (both controlled and uncontrolled)).
- The taxation position of the group (consolidated financial statement; details binding rulings, APAs).

The Local File, among others shall contain the following relevant information:

- The organisation structure of the taxpayer and the introduction of those entities/person to whom the taxpayer has reporting obligation (new requirement)
- A detailed introduction of the taxpayer's activity and business strategy (*partly new requirement*)
- The introduction of the taxpayer's main competitors (new requirement)
- Per transaction type:
 - The copy of the related party agreement(s) or in case of a verbal agreement a detailed introduction of the relevant terms and conditions (*partly new requirement*).
 - The introduction of the relevant market(s), economic circumstances.
 - The identification data of related parties and the amount of payments per related party (*partly new requirement*).
 - Detailed functional and economic/benchmarking analysis (*partly new requirements*).
- The copy of relevant APAs issued by foreign TAs (new requirement)

The Simplified documentation form for low value-added services remained applicable.

The obligatory use of interquartile range has been extended also for CUP Method in certain cases.

The Local File shall be prepared on a yearly basis until the date of filing the CIT return while the Master File is required to be available within 12 months after the closing date of the taxpayer's fiscal year.

Both the Master File and the Local File can be prepared in foreign languages (not defined in the decree, but English, German or French might be accepted).

Tax audit procedure

TP was one of the primary fields of tax investigations in the past years and considering the recent changes in documentation rules, this trend is expected to remain unchanged in the future.

In case of general/full-scope tax audits (which usually cover 1 – 3 tax years), the likelihood of checking the TPD's availability and formal compliance is very high while the possibility of challenging the transfer prices is medium.

Since a relatively large number of limited risk manufacturers are operating in Hungary, several TP cases are related to the lossmaking of such entities. However, financial transactions (deposits, loans, etc.) shall also be considered as high-risk areas.

Income adjustment, surcharges, and penalties

In case of revealing a tax shortfall, a tax penalty up to 50 percent of the amount of unpaid tax is applicable, together with a late payment interest which is 2-times the base interest rate of the National Bank of Hungary.

When breaching the documentation obligation, a default penalty of up to HUF 2 million – HUF 8 million (approx. EUR 6,500 – EUR 26,000) per document (which practically means that per transaction type per financial year) can be imposed.

Advance pricing agreements

Since 2007, taxpayers may file an APA request. The relevant rules are to be found in Act XCII. of 2003 on the Rules of Taxation and in Decree No. 38/2006. (XII.25.) of the Ministry of Finance.

Unilateral, bilateral and multilateral APA-s are all applicable and the fees vary accordingly:

- Unilateral APA: HUF million 0.5 – HUF 7 million (approx. EUR 1,600 – EUR 22,700), depending on the applicable OECD method and pricing of the transaction.
- Bilateral APA: HUF million 3 – HUF 8 million (approx. EUR 9,700 – EUR 26,000), depending on the applicable OECD method and pricing of the transaction.
- Multilateral APA: HUF million 5 – HUF 10 million (approx. EUR 16,200 – EUR 32,500), depending on the applicable OECD method and pricing of the transaction.

Preliminary (anonymous) consultation with the Hungarian TA regarding the possibility of an APA procedure is free of charge until December 31, 2017. As of January 1, 2018, a consultation fee of kHUF 500 (EUR 1,600) per occasion is expected to be applied.

In case of an approval, the maximum period for the advance pricing agreement is 3 – 5 years.

Ex post measures to prevent double taxation

Hungary has signed onto the MLI on June 7, 2017 and the country has DTTs in effect with 78 countries.

The MAP request generally must be filed to the Ministry for National Economy, while in TP specific cases to the National Tax and Customs Administration within the general time limit of tax assessments (which is 5 years from that calendar year when related tax return was due to be filed).

Local administrative appeal procedures are also available for the taxpayers while roll-back APA does not exist.

Intercompany financing

There are no specific rules regarding the intercompany financing. However, considering the Hungarian TA's practice, the following key conclusions have been drawn in the past years:

- The the Hungarian TA may not recognise intercompany deposit transactions since according to Hungarian law, only financial institutions are allowed to collect deposits. There are several known cases, when the Hungarian TA requalified an IC deposit to a loan transaction and made an assessment based on the difference between the interest rate applied and the the arm's length loan interest range.
- In case of loans denominated in HUF or EUR, the National Bank of Hungary publishes monthly statistics about the average interest rates applied by commercial banks to corporate clients. These statistics are considered by the Hungarian TA as a kind of most reliable data set, so should there be any significant deviation from these statistics in case of a related party loan, it should be supported by a robust analysis. However, the Hungarian TA also uses other data sources (e.g. Reuters LoanConnector) for evaluating IC loans.

Safe harbour provisions/exemptions for SMEs

a. Safe harbour rule

Safe harbour rule applies solely for low value added services, as follows:

- For fiscal years starting before January 1, 2018: a cost plus markup range of 3 percent – 10 percent.
- For fiscal years starting on or after January 1, 2018: a cost plus markup range of 3 percent – 7 percent

If the low value-added services are priced on a cost-plus basis and the applied markup falls within the safe harbour range, no benchmarking study need to be prepared and the TPD can be managed in a simplified approach.

b. Exemptions

Hungarian legislation allows for several exemptions, both for entities and certain transactions. The most relevant rules are the following:

- Micro and small-sized enterprises, and those entities in which the state has a direct or indirect majority control are fully exempted from documentation obligation.
- The following transactions are also exempted (even if the taxpayer has other transactions to be documented):
 - If the taxpayer entered into a contract with a related party prior to the beginning of their legal relationship as related parties, the contract will only be subject to the documentation requirement if any of the major terms and conditions is amended, or if there are any changes that uncontrolled parties take or would take into account when determining prices.
 - If the taxpayer has concluded a contract with a private individual (except when the private individual entered into the contract as a private entrepreneur).
 - If the transaction is covered by an APA.
 - If liquid assets are transferred or received without consideration.

- If the transaction is a simple pass-through based on an invoice issued by an uncontrolled party (no markup can be charged for the exemption).
- If the arm's length value of the given transaction type does not exceed HUF 50 million in the tax year. When examining the transaction value, agreements with a similar subject shall be aggregated.
- If stock-exchange transactions are executed under the Act on Capital Markets or if the taxpayer applies a fixed price approved by the competent authorities, or any other price specified by law.

TP and PEs (AOA)

Hungary applies the AOA, for which reference can be found in the CITA. However, some Tax Treaties may include different rules, especially those which have been concluded before adapting the AOA.

The Hungarian tax legislation allows only the “direct method”, where overhead costs shall be allocated based on the revenues/net sales.

Other topics

The Hungarian TA prefers the use of local comparables when the tested party is a Hungarian entity. The Hungarian TA uses Amadeus and Orbis databases, but there are some local products available especially for TP analysis purposes, which are also generally accepted. According to the new regulation (MNE decree), the taxpayer will be obligated to prepare a new benchmarking study in 3-year periods and update the comparables' financial data on a yearly basis.

The general statute of limitations also applies to TP issues and is 5 years after the end of the period in which the tax return was due to be filed.

The Hungarian CbCR legislation came into force as of May 31, 2017. The law applies the OECD's relating minimum standards. Companies that are part of a MNE with a total consolidated turnover reaching €750 million have to notify the Hungarian TA about the reporting entity of the group. The notification has to be made first for the fiscal year started on or after 1st January 2016. The notification shall be filed within 12 months after the closing date of the fiscal year concerned. In case of breaching the notification obligation, a default penalty of up to HUF 20 million (approx. €65,000) may be imposed.

Contact information

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India



Statutory rules/laws

- Sections 92 to 92F of the Indian Income Tax Act, 1961 (the Act) covers intra group cross border transactions.
- Referred to as the “TP Law in India”

Definition of related party

As per TP Law in India, associated enterprise (“AE”) (related party) in relation to another enterprise, means an enterprise:

- Which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or
- In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.

Also, there are thirteen cases, apart from the above, in which two enterprises shall be deemed to be AEs, such cases are covered in Subsection (2) of the Section 92A.

Treatment of the OECD Guidelines

The Indian TP Regulations were introduced in 2001 and are largely in line with the OECD Guidelines.

Accepted TP methods and priority

According to the TP regulations in India, the arm’s length price in relation to an international transaction or specified domestic transaction shall be determined by any of the methods specified by the OECD Guidelines, and any method which takes into account the price which has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non AEs, under similar circumstances, considering all the relevant facts. Nevertheless, contrary to the OECD Guidelines’ “methods hierarchy,” there is no priority of methods in the TP law in India.

Documentation requirements

a. Filing deadline

The accountant’s report (under Form 3CEB) needs to be filed along with the return of income, and time limit for furnishing Form No. 3CEB is on or before 30th November of the relevant assessment year.

A detailed list of mandatory documents are given in Rule 10D(1) of the Income Tax Rules, 1962

1. Entity related

- Ownership Structure
- Profile of multinational group
- Business description/Profile of industry

2. Price related

- Nature and terms (including price) of international transactions
- Description of functions performed, risk assumed, and assets employed (functional analysis)
- Records of economic and market analysis (economic analysis)
- Record of budgets, forecasts, financial estimates
- FAR Analysis
- Any other record of analysis (if, any) to evaluate comparability of international transaction with uncontrolled transaction(s).
- Description of method considered with reasons of rejection of other methods.
- Details of TP adjustment(s) made (if, any)

3. Transaction related

- Any other information e.g. data, documents like invoices, agreements, price related correspondence etc.

4. List of supporting documents are also provided in the law

- Official publications/reports/databases/studies
- Market research studies/technical publications
- Price publications including stock exchange and commodity market quotations
- Published accounts/financial statements relating to business affairs of AEs
- Agreements/contracts with AEs or non AEs
- Letters and other correspondence documenting any terms between the assessee and the AEs
- Documents issued in connection with various transactions
- Period of maintenance of documentation:
 - The prescribed information & documentation should be contemporaneous and must be in existence by the specified date – November 30th following the end of the Financial Year
 - Documentation to be retained for period of eight years from the end of relevant assessment year – Rule 10D(5) of the Rules

5. Rule 10D(2) – Threshold limit

Master file

If the aggregate book value of international transactions < INR One Crore – No need to maintain above prescribed documentation.

Also as per Rule 10DA:

- If the consolidated group revenue of the international group exceeds Rs.500Cr and
 - Books of accounts, exceeds fifty crore rupees
 - Purchase, sale, transfer, lease or use of intangible property exceeds ten crore rupees

Keep and maintain the following information and documents of the international group in Form 3CEAA and may be furnished at any time on or before the 31st day of March, 2018. (this year being an exception)

Country by country reporting

Every parent entity or the alternate reporting entity, as the case may be, resident in India, shall, for every reporting accounting year, furnish the report to the Director General of Income-tax (Risk Assessment) in Form No. 3CEAD.

b. Mandatory language

Although there are no formal language requirements, English is, almost always, used in practice.

c. Alignment with new Ch. V of OECD Guidelines/Action 13 of BEPS?

India implements Action 13 recommendations as follows:

CbCR

Ultimate Indian Parent entity or Indian Resident Alternate Reporting Entity ('ARE') of international group are required to file CbCR in India:

- if the total consolidated group revenue exceeds Euro 750 mn (~INR 5,625 crs)
- from FY 2016-17 onwards
- on or before the due date of filing of Return of Income i.e., no later than 12 months after the last day of the Reporting Fiscal Year of the MNE Group.

Master file

Every Constituent entity of the international group is required to maintain a Master File. The detailed rules and the threshold limit pertaining to Master File are yet to be notified.

Local file

Although the rules pertaining to Local File are yet to be notified, the same needs to be maintained by every country as per their existing local regulations.

Tax audit procedure

The assessment process under the TP Law in India is as follows:

1. Tax return and Accountant's Report need to be filed within the due date.
2. Reference to be made to TPO (TP Officer) by the AO (Assessing Officer) based on risk based assessment approach.
3. Notice to be issued by the TPO – TPO calls for supporting documents & evidence.
4. TP Audit stages:
 - i. TPO issues a preliminary questionnaire
 - ii. File all the relevant documents with the TPO's office (TP Report, AR, Agreements, etc.), updated margins, RPT details, eliminating loss making companies, business profile of assessee and comparables, specific details on economic analysis
 - iii. TPO issues a show cause notice (SCN), which includes the reasons as to why the TPO believe that an adjustment should be made
 - iv. File a reply to the SCN ~ research, detailed response filed
 - v. TPO passes the order and sends a copy to the AO
 - vi. AO passes a draft order.

Based on the results of the abovementioned procedure, the AO passes the order.

Income adjustment, surcharges, and penalties

- a. "Primary adjustment" to TP means the determination of TP in accordance with the arm's length principle resulting in an increase in the total income or reduction in the loss, as the case may be, of the assessee.
- b. Secondary Adjustment in certain cases:

Where a primary adjustment to TP –

- a. has been made suo motu by the assessee in his return of income;
- b. that was made by the AO has been accepted by the assessee;
- c. is determined by an APA entered into by the assessee under section 92CC;
- d. is made as per the safe harbour rules framed under section 92CB; or
- e. is arising as a result of resolution of an assessment by way of MAP entered into under section 90 or section 90A for avoidance of double taxation,

The following are the penalties for various defaults as per the TP regulations in India:

| Name | Penalty |
|---|---|
| Post-inquiry adjustment (deemed concealment of income) à u/s 270A | <ol style="list-style-type: none"> 1) No penalty, where transfer pricing documentation maintained, transaction declared and material facts disclosed 2) Penalty at 50% of tax on transfer pricing adjustment, where transfer pricing documentation not maintained. 3) Penalty at 200% of tax on transfer pricing adjustment, where the TP adjustment is in consequence of not reporting an international transaction |
| Failure to maintain information or documents/Fails to report transactions/Maintains or furnishes an incorrect information or documents à u/s 271AA | 2% of Transaction Value |
| Failure to furnish information or documents à u/s 271G | 2% of Transaction Value |
| Failure to furnish accountants report à u/s 271BA | Rs. 1,00,000 |
| Failure to furnish the Master File by prescribed date à u/s 271 AAB | Rs. 5,00,000 |
| Furnishing inaccurate particulars in the CbCR (subject to certain conditions) à u/s 271 AAB | Rs. 5,00,000 |
| Failure to submit CbCR by the reporting entity* <ol style="list-style-type: none"> a) Where period of failure ≤ 1 month b) Where the period of failure > 1 month c) Continuing default after service of penalty order à u/s 271GB | Rs. 5,000 per day Rs. 15,000 per day Rs. 50,000 per day |
| Failure to respond within 30 days to CbCR related queries [extendable by max 30 days] à u/s 271GB | Rs 5,000 per day upto service of penalty order Rs. 50,000 per day for default beyond date of service of penalty order |
| Furnishing of incorrect information in any report or certificate furnished by an accountant or a merchant banker or a registered valuer à u/s 271J | Rs. 10,000 for each report or certificate to be paid by the issuer of certificate |

Advance pricing agreements

Any person may, if desires to enter into an APA, needs to furnish an application in Form No. 3CED along with the requisite fee. The application shall be furnished to Director General of Income-tax (International Taxation) in case of unilateral agreement and to the CA in India in case of bilateral or multilateral agreement.

Amount of international transaction entered into or proposed to be undertaken in respect of which agreement is proposed during the proposed period of agreement.

| Amount of international transaction entered into or proposed to be undertaken in respect of which agreement is proposed during the proposed period of agreement | Fee |
|---|-------------|
| Amount not exceeding Rs. 100 crores | 0.10 Crores |
| Amount not exceeding Rs. 200 crores | 0.15 Crores |
| Amount exceeding Rs. 200 crores | 0.2 Crores |

The APA shall be valid for such period not exceeding five consecutive years as may be specified in the agreement.

Roll back provisions: The APA Scheme provides roll back mechanism. The APA may, subject to such prescribed conditions, procedure, and manner, provide for determining the arm's length price or for specifying the manner in which arm's length price is to be determined in relation to an international transaction entered into by a person during any period not exceeding four previous years preceding the first of the previous years for which the advance pricing agreement applies in respect of the international transaction to be undertaken in future.

A fee of Rs.5 lakh will be charged by the tax department for the application.

Ex post measures to prevent double taxation

India has signed to the MLI, with some important exceptions.

a. Action 2 – Hybrid mismatch

- i. Article 3 – Fiscally Transparent Entities: India has reserved its right to not apply Article 3 to its 'covered tax agreements'.
- ii. Article 4 – Dual Resident Entities: India has not made any reservations in respect of this Article

b. Action 6 – Preventing treaty abuse

- i. Article 6 – Purpose of a Treaty: Article 6 is a minimum standard
- iii. Article 7 – Prevention of Treaty Abuse:
 - a. Principal Purpose Test ("PPT"): Article 7 is a minimum standard – the PPT will apply to all of India's covered tax agreements
 - b. Simplified Limitation on Benefits ("LOB"): This is not a minimum standard – India has chosen to apply Simplified LOB – will apply only if treaty partners have applied it.

- iv. Article 10 – PEs in third jurisdictions:
 - a. India has not made any reservations in respect of this Article – applicability depends on whether its treaty partners have made any reservations
 - b. This article is a minimum standard.

c. Action 7 – Artificial avoidance of PE

- i. Article 12 – Commissionaire & similar strategies: India has not made any reservations in respect of this Article – applicability depends on whether its treaty partners have made any reservations
- ii. Article 13 – Specific Activity Exemptions: Article 13 is not a minimum standard
- iii. Articles 14 and 15 – Splitting-up of contracts: This is not a minimum standard.

Intercompany financing

i. Equity share

As per Section 92B, the expression “international transaction” shall include capital financing, including any type of long-term or short-term borrowing, lending or guarantee, purchase or sale of marketable securities, indicating the TP regulations to be applied in such transaction.

ii. Interest on loans

Neither the Indian TP regulations nor the OECD Guidelines provide specific guidance on how to determine an arm's length rate of interest. However, the following are the factors considered by the TPO for determining interest rate and also safe harbour provisions are applicable for the same.

- Credit standing of the borrower
- Size and tenure of the loan
- Currency in which loan is provided and its repayment
- Underlying security
- Guarantee (if any)
- Prevailing Interest rate

iii. Accounts receivables

The expression “international transaction” shall include capital financing, including any type of long term or short term borrowing, lending or guarantee, purchase or sale of marketable securities or any type of advance payments or deferred payment or receivable or any other debt arising during the course of business”

Safe harbour provisions/exemptions for SMEs

- i. The board for the purposes of determination of arm's length price under Section 92C or section 92CA shall be subject to safe harbour rules, which means in such circumstances the Indian TAs shall accept the TP declared by the assessee.
- ii. The safe harbour provisions would be available only if the taxpayer satisfies the eligibility conditions provided in the rules and in respect of such international transactions which are eligible for safe harbour as provided in the rules.
- iii. The amended safe harbour rules on June 7, 2017 (Notification) will be applicable for only three years, from AY 2017-18 to AY 2019-20.
- iv. The taxpayer is required to maintain TPD and furnish Form 3CEB irrespective of the fact that the taxpayer opts for safe harbour provisions.
- v. The rules also set out that no comparability adjustments and benefit of arm's length range (1 to 3 percent) would be available to the TP declared while opting for safe harbour rules.
- vi. The benefits of the safe harbour provisions cannot be availed by a taxpayer who has transactions with AEs, which are domiciled in a "No tax or low tax country or territory" i.e., countries/territories where the maximum marginal rate of income-tax is less than 15 percent.

TP and PEs (AOA)

The TP Law in India adopts the AOA, which provides the base language for a TP-based approach, stating: the profits that are attributable in each Contracting State to the PE are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used, and risks assumed by the enterprise through the PE and through the other parts of the enterprise.

- i. Attribution of profits to be at ALP, using the six methods prescribed under the Indian TP regulations.
- ii. PE would be required to do annual TP Compliance – Documentation and Form 3CEB.
- iii. Attribution of profits using TP principles has also been supported by international guidelines (OECD/UN).

Contact information

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Indonesia



Statutory rules/laws

a. Law

- Law Number 28/2007 Article 18 Regarding Taxation General Provision and Procedures

b. Statutory Ordinances

- Minister of Finance Regulation Number 213/PMK.03/206 – TP Documentation
- Government Regulation No. 10/2011 Procedures for rights and fulfillment of tax obligation.
- Directorate General of Taxes (“DGT”) Regulation Number PER-32/PJ/2011 – Application of Arm’s Length Principles and Fairness between tax-payers in related party transaction.
- DGT Regulation Number PER-43/PJ/2010 – Subject determination of local taxpayer and foreign taxpayer

Definition of related party – Article 18 (4) – Income Tax Law Number 36 Year 2008 stated the definition of ‘related party’ as follows:

- a. Taxpayer own capital participation directly or indirectly at least 25 percent upon another taxpayers; the relationship between taxpayers through ownership at least 25 percent upon two or more taxpayers, or relationship between two or more taxpayers mentioned latter;
- b. Taxpayer controls the other Taxpayer or two or more taxpayers are under the same control, either directly or indirectly; or
- c. There are family relationship either blood relationship or relationship by marriage within straight lineage or to the side of one degree.

PMK 213/PJ.03/2017 reconfirms that intercompany transactions which include domestic or international related parties are required to disclose stipulated pieces information such as the type of transaction, the value of the transaction, and the transfer price utilised to determine this price.

Treatment of the OECD Guidelines

Although Indonesia has been granted an “enhanced participation” status, it is not a member of the OECD. PMK 213/PMK.03/2017 reconfirms the basic TP concepts and principles of the OECD Guidelines (i.e., Indonesia adopts the OECD Guidelines).

Accepted TP methods

According to DGT Rule: PER 32/PJ/2011, the TP methods that could be applied are the methods prescribed by the OECD Guidelines.

The most appropriate method “test which needs to be utilised in order to select the transfer pricing method implies that the taxpayer can choose the appropriate method inferring the specific nature of the transaction and the available data. Hereby the following factors should be considered:

- the benefits and drawbacks of each method,
- the appropriateness of the method under consideration of the nature of related party transactions which results from a functional analysis,
- the availability of reliable information which can be included in the usage of the chosen method.
- The degree of comparability of the transactions between related parties compared with transactions on the market, including the reliability of adjustments intended to eliminate any discrepancy of the differences existing.

Documentation requirement

Following the finalisation of BEPS Action 13 in October 2015, the Indonesian Ministry of Finance has issued a new regulation No. 213/PMK.03/2016 (“PMK 213”) on 30 December 2016, which requires taxpayers with certain conditions to prepare a three-tiered approach to TP documentation. Three three-tiered approach to TP documentation (based on BEPS Action 13) consists of three type of documents that need to be prepared by taxpayers:

Master File:

A document presenting information on the overall group entities, including, but not limited to, information on the group structure, functional profiles of the group entities, and contractual obligation of the group entities;

Local File:

A document presenting information on the local Taxpayers and detail information on their related-party transaction(s); and

CbCR:

A report stating information on the financial and tax information of the group entities residing in the respective country/jurisdiction.

The Master File and the Local File should be prepared by taxpayers who fulfill one or more of the criteria stated below:

1. Taxpayers who earned a gross revenue of more than IDR 50,000,000,000 in the previous fiscal year;
2. Taxpayers who conduct related party transaction(s), in the form of tangible good transaction(s), of more than IDR 20,000,000,000 in the previous fiscal year;
3. Taxpayers who conduct related party transaction(s), in the form of intangible goods transaction(s), of more than IDR 5,000,000,000 in the previous fiscal year; or
4. Taxpayers who conduct transaction(s) with related party (ies) in a jurisdiction with a lower Income Tax Rate than Indonesia.

A taxpayer that is a subsidiary of an overseas entity should also prepare a CbCR if the country/jurisdiction where the ultimate parent resides:

1. Does not require the filing of CbCR;
2. Does not have an agreement with Indonesia in relation to the exchange of tax information; or
3. The DGT is unable to obtain the CbCR from such country/jurisdiction despite the fact that the country/jurisdiction has an exchange of tax information agreement with Indonesia.

A Taxpayer that resides in Indonesia and acts as the ultimate parent of its subsidiaries should prepare all three-tiers of TP documentation (i.e., Master File, Local File, and CbCR) if the taxpayer earns a consolidated gross revenue of more than IDR 11,000,000,000,000.

Contemporaneous Master File and Local File should be prepared. This means that Master File and Local File should be prepared based on the data and information available when the affiliated transaction(s) occur. The completed documentation should be readily available at the latest 4 months after the end of the fiscal year. Quick action is required to anticipate this requirement.

The CbCR should be prepared based on the data and information available at the end of the fiscal year AND should be readily available at the latest 12 months after the end of the fiscal year.

Tax regulation does not mandate taxpayers to submit the Master File and Local File along with annual CIT Report. However, the regulation clearly states that Taxpayers should submit a prescribed form which declares that the said documents are readily available during the submission of the CIT Report.

The regulation requires taxpayers to submit the CbCR as an appendix of the CIT report in the following fiscal year. For example, the CbCR for FY 2017 should be submitted in the FY 2018 CIT report.

The regulation specifies that the DGT has the authority to deem a taxpayer's related party transaction (s) to be not in accordance with the arm's length principle if the taxpayer fails to prepare/the transfer pricing documentation in a contemporaneous and timely manner.

Furthermore, the documentation should be provided to the tax office upon request within the timeline as specified under the prevailing tax regulations. When the taxpayer fails to submit the documents on time or the taxpayer cannot provide the documents as requested, the tax office shall deem that the taxpayer does not maintain the transfer pricing documentation.

The three-tiered approach documentation should be presented in the Indonesia language, except for taxpayers that obtains an approval for English bookkeeping where they can prepare the documentation using English language along with the Indonesia translation.

Tax audit procedures

There is no separate statute of limitations under PMK 213/PMK.03/2017. However under the tax laws, the Indonesian TA is allowed to conduct a tax audit for enterprises with significant inter company transactions, which include assessing the arm's length nature of related party transactions, within five years from relevant fiscal year.

Despite of the DGT usually rather being focused on royalties, management fees, and interests, a change in focus towards companies with certain revenue criteria, the TP of tangible-, intangible goods-, transaction(s) with related party(ies) located in a jurisdiction with a lower income tax rate than Indonesia, and holding company with consolidated income certain criteria could be noticed.

Generally, the points under examination in an audit for related party transactions can be listed as follows:

- Existence of an exceptional relationship between the parties (since tax adjustments can be made only with regard to related party transactions),
- Selection of comparable independent transactions,
- Selection of examined/audited party and tested transaction,
- Comparability of the circumstances of related party transactions and comparable independent transactions,
- Selection of a profit level indicator for benchmarking,
- Selection and application of a transfer pricing method to apply the arm's length principle.

In general, the risk of an annual tax audit is characterised as medium; however the risk of an immediate tax audit after a taxpayer applies for a tax refund is high. The risk that TP will be reviewed as part of a regular tax audit characterised as high, while the risk that the Indonesian TA will challenge the TP methodology is medium.

Compared to an annual tax audit which is less likely to happen, an immediate tax audit resulting from a taxpayer's application for a tax refund is very likely to occur. Within the scope of a regular tax audit, a revision of TP is probable. The risk for a check of the transfer pricing methods used can be classified as medium.

Income adjustment, surcharges, and penalties

Follows General Provision and Tax Procedure Law, but specifies noncompliance events as follows:

| Non compliance events | | Consequences |
|---|---|---|
| Article 3 Transfer Pricing documentation is not based on contemporaneous data and information |  | Article 3 Deemed as not to have applied the arm's length principle |
| Article 5 Non-compliance during monitoring Tax, or preliminary/tax crime investigation |  | Article 5(3) In case of late submission, TP Doc cannot be considered in the remaining course of the ongoing procedure |
| |  | Article 5(4) In case of failure of submission doc |
| Article 7 Failure to submit statement letter and/or CbCR during tax return filing |  | Article 7(2) & (3) Tax return is considered incomplete |

Advance pricing agreements

PER-43/PJ/2011 regulates APA with the aim of reducing TP disputes. The DGT APA regulation PER 69/PJ/2010 dated December 31 2010, allows unilateral and bilateral APAs. Also MAPs are available under prerequisite of an applicable tax treaty. PER-48/PJ/2010, issued by the DGT on 3 November 2010, regulates the procedures for the application MAPs.

Ex post measures to prevent double taxation

a. Credit method

The Avoidance of Double Taxation Method (P3B) in Indonesia accordance with Foreign Tax Credits as regulation in ITL Article 24 (Credit Method).

If a resident of a Contracting State (country of domicile) derives income from other Contracting State (the source country), the amount of income tax payable in the other Contracting State (the source country) in accordance with the provisions of P3B models, can be credited against the tax imposed on that resident in a Contracting state (country of residence).

However, the amount of the tax credit shall not exceed the amount of income tax in the Contracting State referred to the first (country of domicile), calculated in accordance with the law and its implementing regulations.

b. MAP

The Indonesia CA should try to solve the matter by MAP with CA of the other Contracting State to avoid double taxation that is not in accordance with P3B.

CAs of both Contracting States, by mutual agreement should try to solve any difficulties in application of P3B.

They CAs can deal directly with each other to reach an agreement.

CAs, through consultations, shall develop appropriate bilateral procedures and the conditions, methods, and techniques for the implementation of the MAP.

Contact information

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Ireland



Statutory rules/laws

a. Legislation

- Part 35A of the Taxes Consolidation Act ("TCA") 1997
- Part 47 of the TCA 1997
- Section 432 of the TCA 1997

b. Selection of important administrative circulars

- Tax Briefing No. 7 of 2010
- Revenue e-brief No. 41/2010
- Revenue Operational Manual 35A-01-01
- Revenue Code of Practice for Revenue Audit and other compliance interventions
- Revenue MAP (including TP/APA issues).

Definition of related party

The term "related party" is defined in Section 835B of the TCA 1997 as "associated". The term associated is explained as follows:

a. Where the controlled person is a company

- two persons are associated if one controls the other; or
- both are controlled by the same person.

b. Where the controlled person is an individual

- a company will be treated as controlled by an individual if the individual together with relatives of that individual control it. For this purpose, relative means husband, wife, ancestor, lineal descendant, brother, or sister.

A person controls a company if the person is able to control or to acquire control, either directly or indirectly, of the company's affairs. A person is regarded as having control of a company if the person has or is entitled to acquire:

- the majority of the issued share capital or voting power,
- such part of that capital as would entitle the person on a total distribution of income to more than 50 percent of such distribution,
- or
- such rights as would entitle the person on a winding up or otherwise to more than 50 percent of the distributable assets.

Treatment of the OECD Guidelines

The TP rule in Section 835C of the TCA 1997 is to be construed in such a way as to ensure, as far as possible, consistency with the OECD Guidelines. This effectively introduces into Irish law the OECD Guidelines so far as they relate to trading transactions. The principles for construing rules in accordance with OECD Guidelines are outlined in Section 835D of the TCA 1997.

The legislative framework required to implement CbC reporting has been established and enacted, with effect from 1 January 2016. In June 2016, the Revenue released guidance containing frequently asked questions and answers in connection with the interpretation of legislation and regulations on CbC reporting in Ireland. This guidance has been updated periodically, most recently in December 2016.

Accepted TP methods and priority

The TP provisions apply for accounting periods:

- commencing on or after 1 January 2011,
- in relation to transactions based on terms agreed on or after 1 July 2010.

Section 835C of the TCA 1997 sets out the main TP rules. These are arrangements between associated parties, which:

- involve the supply and acquisition of goods, services, money, or intangible assets, and
- form part of the trading activities of either party.

Where under an arrangement to which these provisions apply an amount receivable in respect of a sale is understated or the amount payable in respect of an expense is overstated, then the arm's length amount will be substituted in each of the cases.

The term "arm's length amount" is the amount that would have been agreed between independent parties.

TP and related documentation should be reviewed at regular intervals to determine whether the pricing remains at arm's length.

Documentation requirements

Section 835F of the TCA 1997 deals with documentation requirements. The Revenue Commissioners' Tax Briefing No. 7 of 2010 also provides guidance on TP documentation obligations.

A person involved in a transaction, which is within the scope of the TP legislation, is obliged to have available such records as may reasonably be required for the purposes of determining whether the income of that person has been computed in accordance with the TP legislation.

The general rules that apply to records apply also to TP records (i.e., they must be prepared in written form in an official language of the State or by means of any electronic, photographic, or other process as permitted for accounting records).

The provisions relating to the making available of records generally are extended to the making available of TP records to an authorised officer.

While it is not intended to provide a prescriptive list of documentation that should be kept for TP purposes, the relevant documentation must clearly identify:

- associated persons for the purposes of the legislation;
- the nature and terms of transactions within the scope of the legislation. Transactions which are clearly in one family (e.g. regular purchases made by a distributor throughout a period of the same or similar products for resale) may be aggregated, provided any significant changes during the period in the nature or terms of the transactions are recorded;
- the method or methods by which the pricing of transactions were arrived at, including any study of comparables and any functional analysis undertaken;
- how that method has resulted in arm's length pricing or, where it has not, what computational adjustment was required and how this has been calculated. This will usually include an analysis of market data or other information on third party comparables;
- any budgets, forecasts, or other papers containing information relied on in arriving at arm's length terms or in calculating any adjustment made in order to satisfy the requirements of the new TP legislation;
- the terms of relevant transactions with both third parties and associates.

Tax audit procedure

Compliance with the TP requirements will be subject to the Revenue Commissioners' Audit. The new provisions reserve such auditing to officers authorised for that purpose by the Irish Revenue Commissioners. This ensures that the Audits concerned will be undertaken by officers who appreciate, and are equipped to deal with, the complexities involved in applying the arm's length principle.

Section 835F of the TCA 1997 imposes an obligation on companies, to whom the section applies, to have available such records as may reasonably be required for the purposes of determining whether the trading income of the company has been computed in accordance with the requirements of Section 835C of the TCA 1997. TP documentation is fundamental to validating and explaining the pricing of intra group transactions. It should be borne in mind that the main purpose in having TP documentation available is to enable a company, if requested, to readily establish to Revenue's satisfaction that its transfer prices are consistent with the arm's length requirements of Section 835C of the TCA 1997.

The legislative requirement is that a company have TP documentation available. There is no requirement for documentation to be kept in a standard form. The company may have the required documentation kept in the form of its own choosing. The legislation does not require that the company itself must prepare the documentation or that the documentation must be in the State. If appropriate documentation is available, for example, where it has been prepared by an associated company for tax purposes in another jurisdiction, it will be sufficient that that documentation can be made available to the Irish Revenue Commissioners.

It is best practice that the documentation is prepared at the time the terms of the transaction are agreed. For a company to be in a position to make a correct and complete Tax Return for an accounting period in which there were trading transactions with associates, the documentation should exist by the time the Tax Return falls to be made.

The Irish Revenue Commissioners issued guidance for its proposed TP Compliance Review (“TPCR”) program. The TPCR program allows authorised officers of the Irish Revenue to send out notifications to selected taxpayers inviting them to self review their TP and report back to the Irish Revenue within three months. The review will be for a specific accounting period.

The report to be provided to the Irish Revenue based on this self review will address:

- The group structure;
- Details of transactions by type and associated companies involved;
- Pricing and TP method for each transaction or group of transactions;
- Functions, assets, and risks of the parties involved;
- List of documentation available or reviewed by the taxpayer; and
- The basis for establishing if the arm’s length standard has been satisfied.

In most circumstances, an existing TP study should suffice. Under the Irish TP regime, counterparty documentation can suffice when it contains sufficient information relating to the Irish operations and transactions undertaken.

Once the TPCR report is submitted within the required time frame, the company will receive a letter from the Irish Revenue outlining their review points.

Where the Revenue Commissioners are satisfied with the responses, no further action is necessary. Otherwise, the company will be required to provide further information. Even where further queries arise, going through the TPCR ensures no formal Audit has yet commenced. On this basis, any additional tax due will be treated as arising from an unprompted disclosure carrying only mitigated penalties.

A case selected for TPCR may be escalated by the Revenue Commissioners to a formal Audit based on an assessment of risk. For example, this might be considered appropriate where the company declines to complete a self review or where the output from the review and any follow up queries indicates that the TP appears not to be in accordance with the arm’s length principle and therefore not in compliance with Part 35A of the TCA 1997.

Income adjustment, surcharges, and penalties

a. Tax adjustment

Once the TPCR report is submitted within the required time frame, the company will receive a letter from the Irish Revenue outlining their review points.

Where the Revenue Commissioners are satisfied with the responses, no further action is necessary. Otherwise, the company will be required to provide further information.

Where the Revenue Commissioners are not satisfied with the responses, and they determine that:

- an amount receivable in respect of a sale is understated or
- the amount payable in respect of an expense is overstated, the Revenue Commissioners will substitute the “arm’s length amount” in each of the cases and tax will be levied on the adjusted taxable profit accordingly.

The term “arm’s length amount” is the amount that would have been agreed between independent parties.

b. Surcharges and penalties

There are no specific TP penalties included within Irish TP legislation. On this basis, standard interest and penalties will apply where any adjustment to taxable profit is made. Part 47 of the TCA 1997 and the Revenue Commissioners’ Code of Practice for Revenue Audit outline the interest and penalty rates. The standard rate of interest is 0.0219 percent per day (8percent per annum).

Going through the TPCR ensures no formal Audit has yet commenced. On this basis, any additional tax due will be treated as arising from an *unprompted qualifying disclosure* carrying only mitigated penalties.

Once a formal Audit has commenced, the ability to mitigate penalties is reduced.

Advance pricing agreements

A formal bilateral APA programme took effect on 1 July 2016. The APA programme replaces Irish Revenues’ ad hoc approach to agreeing to APAs and provides for the initiation of APAs by taxpayers. Ireland actively participates in bilateral APAs, but will not conclude unilateral APAs. Where the relevant issues involve more than two tax jurisdictions, the Irish Revenue will consider entering into a series of bilateral APAs to deal with multilateral situations.

APAs concluded by Irish Revenue adhere to the guidelines contained in “annex to Chapter IV: APAs” of the OECD Guidelines. The EU has also published a EU JTP Forum and Irish Revenue will adhere to the best practices for the conduct of APA procedures as set put in these guidelines.

An application for an APA can be made by:

- A company that is tax resident in Ireland
- A PE of a non-resident company

Ex post measures to prevent double taxation

In the circular, MAPs (including TP/APAs issues), the Irish Revenue Commissioners advise that any company requesting a TP MAP should contact the Director, International Tax Division, Office of the Revenue Commissioners, Cross Blocks, Dublin Castle, D02 F342, Dublin 2, Ireland.

A MAP request must

- be in writing and specify the year(s) involved;
- include the full names and addresses of the parties to the MAP and the tax reference number and tax office for the Irish entity;
- quote the legal basis for the MAP (i.e., the relevant Article in Ireland’s Tax Treaties or EU Arbitration Convention);
- explain why a MAP is considered necessary;
- explain the issues involved (attaching relevant background documentation);

- set out what the the requester considers to be the correct outcome (attaching any documents, case law, etc. backing up the requester's view);
- be submitted in three hard copies.

This document also addresses situations where a company wishes to claim relief from double taxation in the case of a TP adjustment (i.e., a claim for a corresponding or correlative adjustment). Relief must be claimed and cannot be taken automatically.

The Revenue Commissioners require the letter claiming relief to contain certain information, including:

- the legal basis for the claim (i.e., the relevant article(s) in Ireland's Tax Treaties, including a statement as to why the agreement quoted is the relevant agreement, or the EU Arbitration Convention);
- how the relevant enterprises are associated;
- what the TP policy was prior to the audit in the other country (attaching a copy of any documentation evidencing that policy e.g., TP study, economist report, or any other expert advice);
- the elements of the TP policy with which the other country did not agree, and why;
- how the agreement with the other country was arrived at, to include details of:
 - how the enterprise sought to rebut the assessment;
 - the process by which agreement was reached, and how such an agreement is justifiable as arm's length;
 - the quantum of the adjustment agreed and the financial years covered;
 - an account (if relevant) of the considerations leading to acceptance of a negotiated settlement as opposed to litigation (including, where available, a copy of the legal advice the enterprise received);
- a copy of the settlement agreement reached with the other country;
- whether any previous or subsequent years are to be audited where there is a prospect of similar issues arising;
- whether there are audits being undertaken by other countries that might affect the profits of the Irish associated enterprise.

It is important to note that no relief will be available, inter alia, for:

- interest and penalties imposed by the other country;
- secondary/repatriation of profits adjustments implemented under the laws of the other country;
- non deductible payments of a capital nature.

If the merits of the claim are accepted, the Irish associated enterprise will be asked to submit revised tax computations to the Revenue Commissioners for the accounting periods affected in order to compute the quantum of the relief and normally a revised assessment will then issue.

Intercompany financing

Intercompany loans fall within the Irish TP rules (to the extent borrowings are applied or loans are made in the ordinary course of an entity's trade) and a taxpayer is required to adhere to the OECD Guidelines. There are no specific rules or guidance as to how the arm's length nature of an intercompany loan would be evaluated.

There are no specific thin capitalisation rules in Ireland, but some provisions can deny a full deduction for interest payments in certain circumstances.

Safe harbour provisions/exemptions for SMEs

There are no safe harbour methods. However, the TP rules do not apply to SMEs. The key requirement in this regard is that overall enterprise must have less than 250 employees and either turnover of less than €50m or assets of less than €43m. These thresholds are to be applied on a global consolidated basis and the economic interests of controlling individual shareholders must be taken into account in applying the tests.

TP and PEs (AOA)

Irish TP rules do not apply to arrangement between a branch and its head office. However, it is understood that Irish Revenue will refer to the relevant TaxTreaty and the OECD Guidelines on attribution of profit to PEs in analysing the appropriateness of income attributed to a PE.

Contact information

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Israel



Statutory rules/laws

- Israeli Tax Ordinance, Section 85A (“Section 85A”)
- The Israeli Income Tax Regulations (Determination of Market Terms) – 2006 (“ITPR”).

Definition of related party

According to the ITPR, TP applies to any international transaction that occurs between two parties that have “special relations” (defined as relations between a person and his/her relative, control (50% or more) of one side to the transaction over the other, or control of one person/party over both sides of the transaction (directly or indirectly) either alone or with other person/party).

Treatment of the OECD Guidelines

The Israeli Tax Authority (“ITA”) based the ITPR on the OECD Guidelines and the U.S. Transfer Pricing Regulations (“USTPR”). In certain cases, deviations and/adaptations may apply (for example, when using the CUP Method without performing adjustments, the full range should be used rather than the interquartile range).

Accepted TP methods and priority

The ITPR require taxpayers to use a pricing method to determine an arm’s length pricing of intercompany transactions. The method selection process is based on a combination of the “Method Hierarchy” (specified in the OECD Guidelines) and the “Best Method Rule” (specified in the USTPR) and entails the following:

1. First, a method that compares between the price of the international transaction and comparable transactions (the CUP Method prescribed by both the OECD Guidelines and the USTPR). If not applicable, then:
2. One of the following methods that is the most appropriate under the applicable circumstances:
 - a. A comparison between the profit/loss split in the international transaction and comparable companies taking into account the contribution of each party to the transaction, including risks borne and rights in assets related to the transaction (the PSM prescribed by both the OECD Guidelines and the USTPR); or,
 - b. A comparison between:
 - i. The markup on direct expenses in the international transaction and comparable transactions (the Cost Plus Method prescribed by both the OECD Guidelines and the USTPR); or,
 - ii. A comparison between the gross profit margin of the seller in the international transaction and comparable transactions (the RPM prescribed by both the OECD Guidelines and the USTPR). If both not applicable, then;
 - iii. A comparison of a PLI in the international transaction and comparable companies (the TNMM prescribed by the OECD Guidelines and the CPM prescribed by the USTPR);

3. Other Methods – if all the above methods can not be applied – other method, which is the most suitable under the relevant circumstances (the Unspecified Methods prescribed by both the OECD Guidelines and the USTPR).

Documentation Requirements

a. Filing deadline

1. Form 1385:

Along with the annual tax return, for each intercompany transaction, taxpayers must sign and file Form 1385 (“declaration of international transactions”), which must contain the following:

- a. Identify foreign related parties and their residency;
- b. Provide a short description of the intercompany transaction (type of services, assets, etc.);
- c. Provide the price of the intercompany transaction; and,
- d. Sign on a declaration that the prices are at arm’s length.
- e. Indicate if the transaction is one-time occurrence.

Form 1385 must be supported by documentation that meets the requirements described below.

2. Documentation:

Documentation must be provided to the ITA (the tax assessor) within 60 days from the date such documentation was requested by the tax assessor.

b. Mandatory language

Although there are no formal language requirements, the ITA accepts documentation written in Hebrew or English.

c. Alignment with new Ch. V of OECD Guidelines/BEPS Action 13

The ITPR are based on and follow the OECD Guidelines, thus, documentation requirements are consistent with those of the OECD Guidelines. Specifically, documentation must include:

1. Details of the taxpayer, including controlling holders of rights therein, directly or indirectly, all entities held thereby, directly or indirectly, all entities held thereby and by the taxpayer, and details of beneficiaries or recipients of the said rights;
2. Parties to the international transaction, their residency and special relationships between the said parties and the taxpayer;
3. Contractual conditions of the international transaction, including details of the asset, service provided, consideration paid, loan and credit conditions, and guarantees;
4. Field of activity of the taxpayer and business developments in this field;
5. Economic environment in which the taxpayer operates and the risks to which the entity is exposed;
6. Utilisation of intangible assets, whether directly or indirectly;
7. Details of all transactions implemented by the taxpayer party to the transaction, including loans, payment of management fees, partnerships, joint ventures, gifts, guarantees, trust agreements and any other agreements;

8. Comparable transactions, method of comparing selected and comparison characteristics according to which the range of values and the inter-quartile range, as relevant, were determined, details of adjustments and explanation regarding selection of method and adjustments implemented, details of results of comparison, presentation of range of values or inter-quartile range, as relevant, and conclusions derived from comparison to comparable transactions;
9. Method of reporting on the transaction in other countries, including in the framework of request for a pre-ruling, if submitted, reporting on transaction data in other countries and explanation regarding differences, if any, between reporting in other countries and in Israel.

Taxpayers shall also provide, upon a request from the Tax Assessing Officer, additional documents that corroborate the data submitted, such as: intercompany agreements, client/supplier agreements, and tax returns filed with foreign TAs.

Tax audit procedure

The tax assessor may require a taxpayer to provide documentation, materials, and all information pertaining to the taxpayer's international transactions, including information about the foreign entity and the approach by which the transaction price was determined. By doing so, the taxpayer shifts the burden of proof (of whether the transaction is conducted at arm's length or not) to the ITA.

Income adjustment, surcharges, and penalties

According to the ITPR Section 2(c), if the international transaction pricing is outside the range, the price of the international transaction will be considered the median of the range of results achieved by comparable companies. The ITPR does not specify penalty with regards to TP adjustment, although general tax penalties may apply. Additionally, false testament on Form 1385 may result in criminal charges.

Advance pricing agreements

APA may be achieved through the provisions of Section 85A(d). A taxpayer may submit an APA request, which should include all pertinent facts, details, and the pricing approach of the transaction, alongside any documents, evidence, statements, opinions, evaluations, estimates, etc. relevant to the transaction.

The ITA must respond with the conclusion and rationale within 120 days (in certain cases, the ITA may extend the deadline to 180 days, for which the taxpayer must be notified). Failure to respond to the taxpayer within the set timeframe serves as the approval of the APA and pricing of the transaction is accepted as arm's length.

Fees for APA are determined by the Minister of Treasury and may be determined as a percentage of the transaction value.

Ex post measures to prevent double taxation

Israel signed the MLI in June 2017 and intends to begin implementation in September 2018.

Intercompany financing

The ITPR and Section 85A treat intercompany financing in a similar manner as other intercompany transactions, except for in the following cases:

- a. A loan in which **ALL** of the following apply:
 1. The borrower is controlled by the lender;
 2. The loan is not linked to any index and does not bear interest or yield;
 3. The loan cannot bear a maturity date less than 5 years; and,
 4. The loan payoff is subordinate to other liabilities (obligations) and only comes before liquidation.
- b. Capital Note (as defined below) or Bond, as defined in the tax ordinance.

Safe harbour provisions/exemptions for SMEs

Although not specified in the ITPR and Section 85A, the OECD safe harbour provisions/exemptions for SMEs are adopted and implanted where appropriate.

TP and PEs (AOA)

The ITA adopts the AOA, per ITA Circular 4/2016.

Other topics

PE in the Digital Economy

ITA Circular 4/2016 discusses the new developments of BEPS and the digital economy with relations to PE. Furthermore, the Model Treaty is adopted and used in Israel, including definitions and interpretations.

Circular 4/2016 expands on the existing definitions of PE in light of the growing activity in the digital economy in Israel and the world. For example, the definition of “a fixed place of business” (as defined by the Model Treaty) is expanded in the context of the digital economy:

In light of recent years’ digital economy activity boost and the changes in commerce patterns worldwide, some activities that did not constitute PE in the past may well be considered as PE under the new reality. The following are indicators to digital presence in Israel:

- a. Contract for digital services are signed with Israeli residents at a substantial level;
- b. Services offered by the foreign entity are hired/consumed by Israeli residents; or,
- c. Foreign entity provides localised online services (i.e., website in Hebrew, charges in local currency, use of Israeli credit card services, etc.).

Contact information

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Italy



Statutory rules/laws

a. Law

1. Article 110 – paragraph 7 – Italian Income Tax Law (Presidential Decree n. 917 dated 1986), as recently modified by article 59 Decree Law n. 50 issued on April 24, 2017: taxable income deriving from cross border transactions with related companies belonging to the same multinational group are determined at arm's length that is at same conditions and price agreed upon between independent parties acting in comparable situations. This is true both in case of increasing and in case of decreasing amendments to the declared income consequent to TP issues by the Italian TA.
2. Article 26 – Decree Law n. 78 dated 2010: introducing a sort of allowance consisting in the cancellation of penalties deriving from TP disputes with the Italian TA for businesses having at their disposal proper documentation on TP showing the way and the method duly followed to set up prices in cross transactions with abroad related parties.
3. Financial Law n. 147 – paragraphs 281 and following – issued on December 27, 2013: TA's income adjustments for TP are relevant also for the Regional Tax (IRAP) for financial years after 31st December 2007, even if only with limit to financial years from 2008 to 2012 the penalty (from 100 percent up to 200 percent of the higher tax) is not due for IRAP. Moreover, it has to be noted that the penalty from unfaithful Income Tax Returns referred to financial period 2016 and subsequent has been lowered from a minimum of 90 percent up to the maximum of 180 percent of the higher tax due both as Income Tax (so called IRES) and as IRAP.
4. Financial Law n. 208 dated December 28, 2015 – paragraphs 145 and 146 and consequent Ministerial Decree dated February 23, 2017 introducing with effect from year 2016 the Country by Country reporting in application of Action 13 of BEPS.
5. Art. 31-quater added with effect from April 2017 to Presidential Decree n. 600/73 giving the possibility to grant decreasing adjustments to the Italian company's taxable income in application of the arm's length principle further to:
 - a. a MAP duly set-up with foreign TAs;
 - b. the conclusion of tax assessments within the International cooperation whose results have been duly shared between the different States involved;
 - c. A claim the company may apply to the foreign TA after definitive increasing tax adjustments made abroad in compliance with the arm's length principle in a State with which there is a DTT in force or a proper tax information exchange agreement.

b. Statutory ordinances

The Italian TA's Measures, dated September 29, 2010: detailing the content and the structure of the proper TP documentation to be set-up, in order to avoid penalties.

c. Administrative circulars

1. Principles relating to TP in the determination of the taxable income of Italian businesses under control of foreign mother companies, as of September 22, 1980.
2. Principles relating to the choice among different methods of the most suitable one to the specific case in order to fix the proper transfer price, as of December 12, 1981.
3. Principles relating to the setting-up of proper TP Documentation to be safe from penalties in case of issues by Italian TA, as of December 15, 2010.
4. Administration Circular number 21/E dated June 5, 2012, ruling Mutual Agreements and Arbitration Procedures.

Definition of related party

There is no specific definition by Italian Law on TP of “related party”.

The circumstance that one party involved in the transaction is under control of the second party, or both are controlled by a third party, leads to the need of correctly determining the value of the transaction at arm’s length, being the price of it influenced by the control or the relation among parties. The ‘control’ definition is borrowed by article 2359 of Italian Civil Code, according to which controlled companies are those:

1. in whose Shareholders’ meetings, another entity can exercise the most voting rights;
2. in whose Shareholders’ meetings, another entity can use a sufficient number of voting rights to exert its dominant influence;
3. under dominant influence of another entity, in force of particular contractual ties;
4. If a company can exert its remarkable influence on another, both companies are **related**. A remarkable influence is presumed when in the Shareholders’ meeting at least 20 percent of the voting rights can be exercised (10 percent in case shares are listed at the Stock Exchange or other regulated markets).

Anyway, as clarified in Administrative Circular n. 32/9/2267 dated 1980, the definition of related parties cannot be limited to juridical control or link relationships between companies, but it has to be widened to dynamic economic context where price decisions may be the result of one party’s power to influence the other party’s willing, according to the interest of one party or of a group instead of the market mechanisms. At all events, the leading, predominant party has to be characterised by stability in order to exclude a very time-limited or an accidental control.

Treatment of the OECD Guidelines

The Italian TA adopted the OECD Guidelines to a large extend, being the above listed Statutory rules the Italian translation of OECD Guidelines. In particular:

- Article 110 of Italian Income Tax Law provides the Italian version of the OECD’s Arm’s Length Principle in application of article 9 of OECD Model;
- Article 26 Decree Law n. 78 dated 2010 is the Italian application of the OECD’s requirements of proper TP Documentation.

The circulars are under revision from time to time, to follow-up the updating of the OECD standards.

Accepted TP methods and priority

In Italy, the CUP Method, RPM, and Cost Plus Method, in order of preference, are the accepted TP basic methods, if comparable arm's length data can be determined, which are to be qualified as fully comparable with the transaction under review, after making appropriate adjustments with reference to functions performed, risks assumed and assets employed.

In case fully comparable arm's length data cannot be determined, limited comparable data shall be used after making appropriate adjustments under the application of auxiliary and/or alternative profit TP methods, such as TNMM and PSM. As per the Administrative Circular n. 32/9/2267 dated 1980, in most cases into practice, the use of profit methods leads to determine the "normal income" rather than to verify the fair TP.

An exception is provided by article 1 of Financial Law n. 147 – paragraph 177 – issued in December 2013. Companies working in the online advertising and auxiliary services have to use other methods different from the Cost Plus Method for TP purposes, except when they apply to an International ruling procedure.

Documentation requirements

a. In general

Article 26 of Italian Decree Law n. 78/2010 introduced a sort of allowance consisting in the cancellation of penalties for businesses which have at their disposal proper TPD, showing the way and the method duly followed to set up prices in cross transactions with abroad parent companies.

According to the Italian TA's Measures dated September 29, 2010, a proper TPD is articulated in a 'Master File' and a 'Domestic File'.

The Master File has to collect and show information about the multinational group that is: a general description of it in terms of history, recent developments, fields of activities carried on and markets of reference; a representation of roles, actions, strategies and juridical relationships between the different companies within the group by ad hoc flow charts; evidence of the cross transactions, distinguishing the sale of material from that of intangible goods, the rendering of services from that of financial services and, precisely, giving evidence of those services rendered by a member company to be useful for the benefit of other member companies and of agreements between member companies to share costs; details about instrumental equipment invested and risks assumed by each member group company; a list of intangibles owned by each member group company; evidence of the transfer pricing policy adopted within the group and the reason why it is considered to obey to the arm's length principle; a description of the relationships between the TAs of other EU member States with reference to APA and to the ruling procedures.

The Domestic File, focused on the Italian company, has to: generally describe the domestic company, its history, recent developments and markets of reference; describe the national company's economic sector of activity, its operative structure, its strategies and/or any changes in the previous financial year's ones; give evidence of the national company's transactions within the multinational group with specific description of the intra-group operations, of the benchmarking analysis, of the adopted method to set-up the transfer pricing obeying to the arm's length principle; detail parties, contents and terms involved in the list of the intra group transactions.

The documentation is not mandatory to be filed in to TAs, yearly – together with Income Tax Return – but its possession can be duly communicated to the Italian TA by filling with a tick an ad hoc space in the Income Tax Return.

b. Filing deadline

Generally, in case of accesses and inspections by the Italian TA, the Italian company can avoid penalties if within 10 days from the the Italian TA's request, a TPD is submitted as well as, in case of further deepening by the Italian TA, further TP information is added within 7 days after the Italian TA's request.

c. Mandatory language

The Domestic File is required to be in Italian language; while the Master File can be and is mostly prepared in English language even if a translation can be duly provided for upon specific request by the local TA.

d. Alignment with new Ch. V of OECD Guidelines/BEPS Action 13

In terms of additional TP documentation have been recently introduced by Italian Financial Law n. 208/2015 – paragraphs 145 and 146 and consequent Ministerial Decree dated February 23, 2017 requiring the **CbCR** with effect from year 2016 to:

- a. Italian resident controlling companies not controlled in their turn by shareholders other than persons, obliged to consolidated financial statements, with total consolidated revenues amounting to at least €750 million earned within the whole multinational group in the taxable period before the reporting period.
- b. Italian resident controlled companies only in the case the controller foreign company obliged to the consolidation of financial accounts is resident in a state which has not introduced the CbCR or has no/is not compliant with exchange of information with Italy about CbCR.

The CbCR must be sent to Italian Tax Office within 12 months of the last day of the multinational group's taxable period under reporting.

In case of no or of incomplete/wrong data in the CbCR, the administrative penalty provided for can range from €10,000 to €50,000.

With reference to a multinational group, the CbCR has to report aggregated data of all companies belonging to the group for each involved country and in details: revenues; gross profits/losses before income taxes; income taxes due and definitively paid in each jurisdiction; the declared stock capital; not distributed profits; the number of employees; tangible assets different from cash or equivalent means; necessary information to identify each entity belonging to the multinational group; their state of incorporation and of management, in case of difference from the state of their tax residence; the nature of activities run. PE must be reported with reference to the state where they are located duly specifying the entity they are referred to.

Tax audit procedure

The Italian TAs usually examine the adequateness of intercompany TP only during the regular tax audits. The open term for the Italian TA's inspections with effect from year 2016 is 31st December after 6 years from the year the Income Tax Return is referred to. In case of a tax audit, the taxpayer is generally obliged to cooperate with the tax auditors.

The final audit report, including suggestions for any tax adjustments, is presented to the local tax office where the revised tax assessments are to be prepared. The local tax office usually follows the recommendations of the tax auditors.

If the taxpayer does not agree with the revised assessments, within 60 days after the notified results of the audit, has the possibility to fight against them by applying for an appeal procedure.

Income adjustment, surcharges, and penalties

In case of disputes on TP, the Italian TAs are allowed:

1. To submit to Italian taxation the higher income discovered as moved abroad by TP incorrect habits used by the domestic company, not complying with the arm's length principle. The higher income than the one declared is put under 24 percent tax rate for IRES (the companies' Income Tax which up until the past year (2016) was at 27.50 percent rate), as well as to IRAP's (the Regional Tax) tax rate varying from 3.90 percent to 4.82 percent (according to the sector of the activity and the region where it is carried on) calculated on the net value of the output; and,
2. To apply on the domestic company's shoulders a penalty for unfaithful Income Tax Return amounting from a minimum of 90 percent to a maximum of 180 percent of the higher income tax with effect starting from the past year (being from 100 percent to 200 percent up to year 2015). Of course, the before mentioned penalty can be saved in case of the company's possession of proper TP documentation.

Advance pricing agreements

According to article 31-ter Presidential Decree n. 600/1973 which, starting from 2016 replaced article 8 of Decree Law n. 269/2003 and the old procedure ruled by it, Italian companies with international business can apply for an APA also for the definition in advance of the more suitable method to be compliant with the arm's length principle in the pricing of cross border transaction within the multinational group. An APA ties both the claiming company and the Italian TA involved for the period when it is agreed and for the four, years further, of course if situations and conditions at the basis of the APA will not change during the five years it is in force. In case they come in force after further friendly procedures set-up with foreign TAs as provided for by the Tax Treaties, they are binding also according to what agreed with the involved foreign TAs.

An APA is formally started by the taxpayer submitting an ad hoc claim. The sending of the claim is free of charge. Before submission, both the taxpayer and or its tax consultants can have a couple of no name and pre-filing meetings with the tax office in order to have a draft of the claim unofficially examined and to receive suggestions to improve/integrate it with any further required information.

The sole office entrusted to receive APA claims is the International Ruling Office – Central Department of Tax Assessments with one seat in Rome and another in Milan.

Within 30 days after receiving the claim, if everything is OK with documents and information provided, the tax office notifies the taxpayer the APA is in force; otherwise it gives the taxpayer a proper time to integrate it.

After the conclusion of the above first stage, the APA procedure opens with a cross-examination between the taxpayer and the tax office: they can set up the terms and conditions of the APA and the tax office can verify the information provided by the taxpayer and ask for clarifications in case of need. The cross examination can require a couple of or more meetings between parties involved, and the tax office is also allowed to access to the claiming company's offices where the activity is run. The whole procedure can take no more than 180 days to be finalised. This term can be suspended in case International cooperation with other states' TAs is needed to the receiving the required information. Of each cross-examination meeting/ access to offices, minutes are duly written, as well as for the final agreement which will be mandatory for all parties involved.

During the 5 years the APA is in force, the Italian TAs can check if the company is compliant and if something is changed in the transactions carried on and in the company's structure. Therefore, periodic maintenance and updating is somewhat required. When the 5 years expire, there is the possibility to renew the APA by always checking possible new conditions and basis coming out in the meantime. The renewal has to be claimed at least 90 days before the expiration of the APA still in force by starting a similar procedure to that which brought 5 years ago to the APA to be renewed now.

Italian TAs allow unilateral, bilateral or multilateral APAs, depending by the number of foreign related parties within the multinational group and consequent foreign State's Tax Administrations involved in the issue.

Ex post measures to prevent double taxation

In case of TP matters, the taxpayer could fight against the consequent risk of double taxation, by setting up lawsuits under the Tax Court.

Within 60 days later than the receiving of the communication by the Italian TAs about income adjustments consequent to TP issues, the taxpayer, duly represented by its Tax Lawyer, can apply to the Provincial Tax Court (1st degree of litigation) to contest the TA's adjustment act.

In case of negative result, that is the first Court decides in favor of the Italian TA, or even if the first degree decision is in favor of the taxpayer, the Italian TA can fight against it by applying to the Regional Tax Court (2nd degree of litigation). The Lawsuit can go on up to the 3rd and final degree of decision under the Court of Cassation. The final decision of the Court of Cassation is diriment between the fighting parties which can conform to it or can apply to international procedures, such as MAP, to get to a solution involving the different interested countries' TAs.

In Italy, the appeal to MAP is justified both by Art. 25 of the Model Treaty in case extra EU related parties are involved in the dispute and according to the INTRA EU Convention n. 90/436 dated July 23, 1990, in case of disputes between EU related parties.

In both cases, the TAs of the involved countries consult one each other to resolve disputes regarding the TP-related double taxation; the taxpayer each time has the duty to cooperate, giving the necessary and required information and the right to be updated on the reached results.

MAP according to the EU Convention is prevented in case of a judicial lawsuit for the taxpayer's fiscal fraud. It is alternative to the 3 degrees of justice under the National appeal and has to lead to the solution of the dispute.

On the contrary, MAP according to DTT is not alternative to the National appeal and can be set up even if the National Appeal is in due course. Generally, the National Appeal is set up at first and in case it does not lead to an acceptable solution, a DTT MAP is submitted.

During the DTT MAP, it is possible and well worth to suspend the internal juridical appeal to avoid that judges' decisions come into force before the finalisation of the DTT MAP.

If the involved TAs cannot agree upon a result, the taxpayer usually can apply for an arbitration procedure.

Intercompany financing

With reference to intercompany financing, there is no specific rule about TP, and, therefore, it is necessary to refer to the general principles on TP.

The most delicate aspect is the agreed interest rate which has to meet the arm's length principle. Italy follows the OECD Guidelines, and among all the OECD recommended methods, the CUP Method is preferred. Usually for financing agreements, interest rates are determined by adding to a fixed base (simply Euribor rates available on the market) an appropriate spread to remunerate the lender. Therefore, in loan agreements, the correct setting up of the interest rate at arm's length means to pay attention to this spread that must necessarily reflect the target market for the specific kind of transaction.

Among different aspects to be taken under attention in the loan agreement between the lender and the borrower, the first is the geographic location of the comparable market: for the benchmark analysis, the market of reference has to be the lender's market, rather than the borrower's. This is provided for by Italian Income Tax Law and has been also shared by an important judgment n. 22010 of the Supreme Court of Cassation, dated 25th September 2013.

Once established that the market to be taken as a reference is the lender's, a further step is to proceed to analyse the characteristics of the loan agreement and to search in that market proper rates accordingly.

Variable aspects to be taken into consideration in a comparability analysis are: functions and risks borne by parties involved in the transaction; contractual conditions ruling juridical relationships between parties; economic and market conditions; strategies. For instance, with specific reference to contractual conditions in an intercompany loan agreement, it is important to analyse the: amount of the financing; reason; length of the loan; nature of the contract; currency in which the loan is denominated; and any given guarantees. Moreover, the borrower's peculiarities have to be considered with specific reference to the lender's expectations to be paid back. In fact, the higher the possibility that the borrower does not reimburse the loan and/or does not pay the related interests, the higher will be the interest rate applied by the lender onto the financing.

In case the Italian company is the borrower, the deductibility of interest expenses is allowed, according to article 96 of the Italian Income Tax Law, following a specific mechanism of calculation.

Very briefly, first of all, interest expense is compared with interest income earned by the company so that the interest expense up to the amount of the interest earned is always deductible.

Each exceeding amount of interest expense is deductible up to a cap represented by 30 percent of EBITDA. Therefore, if the company makes a loss, almost certainly it is not allowed to deduct any interest expense.

The excess of non-deductible interest expense, because of negative EBITDA, can be carried forward and used in future financial years.

Currently a jurisprudential dispute in Italy is on about non-interest-bearing financing and possible TP issues. Mostly, decisions are in the direction that, even if free-of-charge, the intercompany loan could lead to taxable income's shifting between different states. Therefore, the arm's length has to be duly met in setting up the conditions of the financing.

Safe harbour provisions/exemptions for SMEs

In Italy, safe harbours are expressly provided for transactions of immaterial rights, as the setting up of the value at arm's length in this case is recognised of particular complexity. According to Administrative Circular n. 32/9/2267 dated 1980, royalties granted by the licensee to the licensor for the exploitation of the latter's Intellectual Property/Trade Mark/Know-How, calculated according to a percentage of the licensee's total sales are considered fair:

- a. **up to the 2 percent** of the total sales, when: (i) the transaction is ruled by a written agreement duly set up before the payment of the royalty; (ii) the cost's inherence for the licensee is duly documented and proved;
- b. **from 2 percent up to 5 percent**, when, in addition to the respect of the conditions as per the above point a., the following are duly accounted for: (i) technical features (research and testing activities are required; 1 year/or faster obsolescence; technical life; originality; results got, and so on...); (ii) contractual features (exclusivity; sub-licensing; right to exploit the invention or the immaterial goods' development; (iii) the licensee's real benefit;
- c. **higher than 5 percent**, only in very special situations, such as in case of high technological level acknowledged for the economic field of activity or other circumstances;
- d. **Any amounts of royalties**, paid to licensors based in low taxation level countries can be granted as deductible for the licensee only at the demanding conditions as per the above point c.

Some simplifications are provided for SMEs which in the **Domestic File** have the possibility to avoid updating about the TP method used for intra group transactions over the next two years further to that the set up of the Domestic File is referred to in case: i) the benchmarking analysis is based on information given by public data bases and ii) the determining factors have not been significantly changed over the same period of two years.

SMEs allowed to the above simplifications are those with a business volume or an amount of revenues not higher than €50 million.

TP and PEs (AOA)

Italy has introduced provisions by article 7 of OECD model by completely rewriting article 152 of Income Tax Law. The PE's profits now need to be determined in relation to the gains and losses associated with it, drawing up P&L accounts and a Balance Sheet based onto the accounting principles applicable to the PE. It has been also introduced the principle of the so called "Functional separate entity approach", according to which PE should be considered as a separate and independent entity.

Lastly, it should be noted that by the 2015 reform, the application of TP has been definitively coded for all transactions and business between the PE and the entity to which it belongs.

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Japan



Statutory rules/laws

- ACT ON SPECIAL MEASURES CONCERNING TAXATION (Last amended by Act No.4 of 2017)
- ORDER FOR ENFORCEMENT OF THE ACT ON SPECIAL MEASURES CONCERNING TAXATION (Last amended by Cabinet Order No.158 of 2017)
- ORDINANCE FOR ENFORCEMENT OF THE ACT ON SPECIAL MEASURES CONCERNING TAXATION (Last amended by Ordinance of Ministry of Finance No.24 of 2017)

Definition of related party

The term “foreign related party” means a nonresident, foreign corporation, or his/her or its foreign business place, which has a ‘special relationship’ with a resident, domestic corporation or domestic business place.

The term “special relationship” means:

- (a) A relationship in which either of two corporations owns directly or indirectly at least 50 percent of either the shares or the investment capital of the other corporation.
- (b) A relationship in which at least 50 percent of either the shares or the investment capital of two corporations are owned, directly or indirectly, by the same person.
- (c) A relationship in which a director represents (or a number of directors together represent) at least 50 percent of the directors of one corporation and, concurrently, that director is a director or employee (or those directors are directors or employees) of another corporation.
- (d) A relationship in which one corporation conducts a considerable portion of its business in reliance upon transactions with another corporation, or a relationship in which one corporation procures a considerable portion of the funds necessary for its business activities by borrowing from another corporation, or by receiving guarantees of that corporation.

Treatment of the OECD Guidelines

Japan is a member of the OECD. The National Tax Agency of Japan (“NTA”) considers Japanese TP legislation to be consistent with the OECD TP Guidelines.

Accepted TP methods and priority

The Japanese TP legislation adopts the OECD Guidelines’ methods to reach an Arm’s-Length Price (“ALP”). Additionally, there is no priority between the methods.

Documentation requirements

The Japanese TA adopted a three tiered approach to TPD rules in accordance with the recommendations of BEPS Action 13. All files must be submitted to the Japanese TA through an online system ("e Tax") by the specified deadline. Below is a description of guidelines and requirements in each tier:

CbCR

Reporting entity

i. Primary mechanism

Either of the following Japanese companies which are Constituent Entities of a Specified MNE Group:

- Ultimate Parent Entity
- Surrogate Parent Entity

ii. Secondary mechanism

(This mechanism will be applied in limited cases where the Japanese TA acknowledges that a CbCR is not provided through the jurisdiction in which the Ultimate Parent Entity or the Surrogate Parent Entity is resident for tax purposes).

Either of the following Constituent Entities of a Specified MNE Group:

- A Japanese company which is neither the Ultimate Parent Entity nor the Surrogate Parent Entity.
- A foreign company having a PE in Japan.
- Items to be reported.

i. Overview of allocation of income, taxes and business activities by tax jurisdiction.

Revenues, profit (loss) before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees, tangible assets other than cash and cash equivalents by each jurisdiction

ii. List of all the Constituent Entities of Specified MNE Group included in each aggregation per tax jurisdiction.

Names and main business activities of Constituent Entities by each tax jurisdiction.

iii. Additional information.

Other information to explain the above information.

Language

English.

Deadline for filing

Within 1 year after the end of the reporting fiscal year of the Ultimate Parent Entity.

Penalties

If a reporting entity fails to file a CbCR to the competent tax office by the deadline without good reason, a fine up to JPY300,000 will be imposed.

Master file*Reporting entity*

Either of the following Constituent Entities of a Specified MNE Group:

- A Japanese company.
- A foreign company having a PE in Japan.
- Items to be reported.

Organisational structure, description of businesses, intangibles, intercompany financial activities, financial positions of the Specified MNE Group.

Language

Japanese or English.

Deadline for filing

Within 1 year after the end of the reporting fiscal year of the Ultimate Parent Entity.

Penalties

If a reporting entity fails to file a Master File by the deadline without good reason, a fine up to JPY300,000 will be imposed.

Local file (contemporaneous documentation)

A company conducting transactions with foreign related parties must prepare or obtain documents considered to be necessary for calculating the ALP for the transactions (i.e., Local File) by the filing due date of a final corporation tax return and preserve them for 7 years (9 years for fiscal years in which tax losses are incurred, and 10 years for fiscal years beginning on or after 1 April 2018).

Company which must prepare a local file

A company that conducts transactions with foreign related parties.

Transactions not subject to contemporaneous documentation

Transactions with related foreign parties for the current fiscal year are exempt from the contemporaneous documentation requirement provided that both of the following conditions are met:

- Total transaction amount with the foreign related party for the previous fiscal year (the current fiscal year if the previous fiscal year does not exist) is less than JPY 5 billion.
- Total transaction amount for intangibles with the foreign related party for the previous fiscal year (the current fiscal year if the previous fiscal year does not exist) is less than JPY 300 million.

Documents to be prepared/obtained

i. Transactions subject to contemporaneous documentation:

| Documents | Contemporaneous documentation | Deadline of presentation or submission (a) |
|--|-------------------------------|--|
| Documents considered to be necessary for calculating the ALP for the transactions (Local File) (b) | Required | 45 days |
| Documents considered to be important for calculating the ALP for the transactions (c) | Not required | 60 days |

(ii) Transactions not subject to contemporaneous documentation

| Documents | Contemporaneous documentation | Deadline of presentation or submission (a) |
|---|-------------------------------|--|
| Documents considered to be important for calculating the ALP for the transactions (d) | Not required | 60 days |

- a. The Japanese TA may ask a company to present or submit the above documents in the event of tax audit. The deadline of presentation or submission is designated by the Japanese TA within 45 days or 60 days indicated above. If the company fails to present or submit such documents by the deadline, the Japanese TA may make assessment presumptively and inspect third parties conducting similar trade or business.
- b. Documents containing details of transactions with foreign related parties.
 - Documents used to determine the ALP.
- c. Documents consisting of items that provide the basis of the Local File.
 - Documents consisting of items related to the Local File.
 - Other documents.
- d. Documents equivalent to the Local File.
 - Documents consisting of items that provide the basis of the Local File.
 - Documents consisting of items related to the Local File.
 - Other documents.

Notification of Ultimate Parent Entity for CbCR:*Reporting entity*

Either of the following Constituent Entities of a Specified MNE Group:

- A Japanese company.
- A foreign company having a PE in Japan.

Items to be reported

Name, location, corporate number of the Ultimate Parent Entity or Surrogate Parent Entity and the name of its representative.

Deadline for filing

The end of the reporting fiscal year of the Ultimate Parent Entity.

Definitions of keywords*Enterprise Group*

- i. a collection of enterprises for which consolidated financial statements are compiled or (ii) a collection of enterprises for which consolidated financial statements would be compiled if shares in the parent company were listed, provided that the parent company of the group is not a subsidiary of other collections of enterprises for which consolidated financial statements are compiled or for which consolidated financial statements would be compiled if shares in the parent company were listed – MNE Group (multinational enterprise group).
- ii. an Enterprise Group consisting of Constituent Entities who reside in two jurisdictions or more or (ii) an Enterprise Group consisting of Constituent Entities who reside in the same jurisdiction but have PEs in other jurisdictions.

Specified MNE Group

An MNE Group whose total consolidated revenue for the preceding fiscal year of the Ultimate Parent Entity is JPY100 billion or more.

Constituent Entity

- i. an entity of an Enterprise Group of which assets and profits/loss are included the consolidated financial statements of the Enterprise Group (including those which would be compiled if shares in the parent company were listed) and (ii) an entity of an Enterprise Group of which assets and profits/loss are not included the consolidated financial statements of the Enterprise Group solely for size or materiality grounds.

Ultimate Parent Entity

One of the Constituent Entities in an Enterprise Group that controls other Constituent Entities of the group through holding majority of the voting rights, etc. and is not controlled by any other persons in the group.

Surrogate Parent Entity

One of the Constituent Entities other than the Ultimate Parent Entity in a Specified Enterprise Group, which the Ultimate Parent Entity has appointed as a reporting entity of CbCR.

Tax audit procedure

In general, NTA reviews various information such as websites, publicly disclosed financial statements, corporate income tax returns including TP related documentation, etc., to identify taxpayers who display signs of income transfer. NTA then requests additional information from those taxpayers and conduct on-site inspection.

Income adjustment, surcharges, and penalties

In addition to additional CIT due to correction of taxable income, following penalty taxes will be charged as an administrative penalty;

Penalty tax for under-reporting

10 percent of the tax increment resulting from a correction or an amended return, when the original final return was filed on or before due date.

Heavy penalty tax

In fraud cases, 35 percent of the additional tax instead of the penalty tax is payable for a short return.

A grace period for the payment of CIT and penalties thereon may be granted for those requesting a MAP under the relevant Tax Treaty.

Advance pricing agreements

Corporations are eligible to file requests for APAs relating to some or all foreign-related transactions with the District Director (or the Regional Commissioner of the Regional Tax Bureaus (“RTB Commissioner”) in cases where the corporations are those under the jurisdiction of the RTB Large Enterprise Examination Division under the Ministry of Finance Ordinance No.49 of 1949) who has the responsibility for the corporation’s returns

Upon request for APA, an applicant shall file a ‘Request for APA of the TP Methodologies (“TPM”)' (appended form 2) for each address in their country with the District Director of the precinct RTB. This will be done by the commencing date of the first taxable year of the taxable years that the applicant is requesting to be confirmed.

Applicants for APA shall be requested to submit Japanese translations if any of the attached documents are written in foreign languages.

In cases where a corporation that has received a notice of APA confirmation files tax returns complying with the content of the APA pertaining to the confirmed foreign-related transactions in each taxable year, the District Director shall treat the confirmed transactions having been conducted at the arm’s length price.

Ex post measures to prevent double taxation

“The Commissioner’s Directive on the MAP (Administrative Guidelines: last amended 30 June 2017)” issued by NTA provides MAP guidance to taxpayers required by the recommendation of the BEPS Action 14 Final Report published in October 2015.

Intercompany financing

On lending and borrowing activities between a corporation and a foreign related party, in cases where neither party is engaged in lending or investment activities in business, an application of a method equivalent to a method consistent with the CUP method using following interest rate as arm's length interest rate shall be considered where necessary.

1. The interest rate that would be applied to a loan borrowed by a borrower of the foreign related transaction, assuming that the borrower made the loan from an unrelated bank under similar conditions in terms of currency, borrowing date, and borrowing period to those of the foreign related transaction.
2. The interest rate that would be applied to a loan, assuming that the lender involved in the foreign related transaction made the loan from an unrelated bank under similar conditions in terms of currency, borrowing date, and borrowing period to those of the foreign related transaction.
3. The interest rate that would be earned on the funds involved in the foreign related transaction, assuming that they were invested in government securities or the like under similar conditions in terms of currency, transaction date, and transaction period of the foreign related transaction.

Note:

1. Results consistent with the arm's length principle are obtained in the order of the methods using the interest rates listed in (1), (2) and (3).
2. In cases where the interest rate set forth in (2) is applicable, and the loan made from a bank to the lender in the foreign related transaction is a loan made under similar conditions in (2), whether the loan has a conditional relationship with the foreign related transaction is of no relevance.

Safe harbour provisions/exemptions for SMEs

There are no provisions or exemptions allowed relating to SMEs.

TP and PEs (AOA)

In a 2014 Japanese tax reform, it was approved to change from "Entire Income Principle" to "Attributable Income Principle" and adopt the AOA for calculation of income attributable to PE.

Contact information

For more information and TP related issues in Japan, please contact:

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Mexico



Statutory rules/laws

In Mexico, TP and related party transactions are regulated, only for tax purposes, in the Income Tax Law, mainly in Chapter II (Multinational Enterprises), of Title VI (Preferred Tax Regimes and Multinational Enterprises). Under these provisions, the terms related party transactions and comparable entities and/or operations are defined. Within the Income Tax Law and the Federal Tax Code, there are certain provisions related to TP transactions, which are:

a. Income tax law

- Article 11 of the Income Tax Law (Interest considered as dividends).
- Article 76, subsections IX, X and XII, of the Income Tax Law. (Obligations)
- Article 90 and 110, subsections X y XI of the Income Tax Law. (Transfer pricing for individuals).
- Articles 179, 180 and 182 of the Income Tax Law (Title VI. Chapter II. Multinational Companies).
- Article 34-A of the Federal Tax Code (Advanced Pricing Agreements).
- Article 83, subsection XV and article 84, subsection XIII of the Federal Tax Code (Infractions and penalties).

b. Statutory ordinances

- Article 302 of the Regulations of the Income Tax Law (Interquartile method).

c. Selection of important administrative rulings

- Miscellaneous Tax Resolution ("MTR")
 - Rule 2.12.7. Analysis with authorities prior to consultations on related party transactions (pre-filing briefs).
 - Rule 3.3.1.28. Request for authorisation to deduct interest on debts owed to related parties (thin capitalisation).
 - Rule 3.18.24. Withholding taxes on remittances to related parties located in tax havens.
 - Rule 3.9.3. Deadline to submit information of transactions with related parties.
- Criterion issued by the Tax Administration Service – ("SAT", for its acronym in Spanish).
 - 67/2013/ISR. Thin Capitalisation.

Definition of related party

In Mexico, the concept “related parties” is very broad. For companies, article 179 defines such term as follows:

“Two or more persons shall be deemed related parties when one participates directly or indirectly in the administration, control, or capital stock (equity) of the other(s). Persons or entities which are part in a joint venture shall be considered as related parties among them”.

For individuals, besides direct or indirect participation or interest in the administration, management, control, or capital stock in a certain entity or corporation, an individual is considered as a related party to another individual or person, when he or she has a link or bond according to the Customs Law. Article 68 of the Customs Law establishes that bonds between persons exist in the following cases:

- i. When one of them holds an office of direction or responsibility in the other party.
- ii. If they are legally acknowledged as business associates or partners.
- iii. If they are related as employer and employee.
- iv. If one holds direct or indirect title, control or possession of 5 percent or more of the shares, corporate participations, contributions, or instruments in circulation and with right of vote of both.
- v. If one exercises direct or indirect control of the other.
- vi. If both are controlled directly or indirectly by a third person.
- vii. If both of them together have direct or indirect control of a third person.
- viii. If they are members of the same family.

Article 110 of the Regulations of the Customs Law establishes that link shall be deemed to exist between members of a family if there is a kinship at law, by legitimate or natural consanguinity without limitation of degree, in direct line to the fourth collateral or transversal degree, by affinity in direct line or in the second transversal degree, and between spouses.

Treatment of the OECD Guidelines

According to the last paragraph to article 179 of the Mexican Income Tax Law and SAT Criterion 75/2013/ISR, the OECD Guidelines are applicable for interpretation of the provisions of Chapter II, Title VI of the Income Tax Law (TP), if they are congruent with the provisions hereof and with Tax Treaties entered into by Mexico.

Accepted TP methods and priority

Article 180 of the Income Tax Law recognises the TP methods specified by the OECD Guidelines.

Priority

In every case, the use of traditional methods must be privileged, starting by the CUP Method. Only when it is not the most appropriate method, the rest of the methods can be applied, considering the most reliable in accordance with the information available, with preference being given to the RPM or the Cost Plus Method. In that same context, the directives for adjustments to comparable prices, considerations, and samples, are set forth.

Documentation requirements

a. Filing deadline

TP documentation must only be submitted upon request of the Mexican TAs. However, certain information concerning related-party transactions and the TP methods selected must be provided within the annual tax return, which must be filed before March 31st each year.

b. Mandatory language

The information and documentation should be in Spanish; if it is in a different language, it should be accompanied with a legal translation.

c. Documentation

In cases of taxpayers executing operations with non-Mexican resident related parties, they are required to obtain and conserve evidence and documents showing that the amount of their revenues and deductions were agreed upon following the arm's length principle, as it would have happened in operations with independent parties. Such documentation must comprehend the following information:

- i. The name, corporate name, domicile and residence for tax purposes of the related parties with whom such operations are executed, and documents evidencing the direct or indirect participation;
- ii. Information of the functions or activities, assets used, and risks assumed by the taxpayers for each operation;
- iii. Information and documentation of the transactions with related parties, as well as the amount thereof, by each related party and by transaction;
- iv. The method applied pursuant to Article 180 hereof, including information and documents on comparable operations and enterprises, for each type of operation.

According to article 276 of the Regulations of the Income Tax Law, range of prices, amount of compensation, or profit margins must be adjusted by application of the interquartile method. Taxpayers may use statistical methods other than the interquartile method, only if the method used is agreed upon within the framework of an amicable procedure provided in Tax Treaties entered into by Mexico, or when the method is authorised through general rules issued for the purpose by the Mexican TA.

TP analysis may be performed with the financial information of the Mexican company or with the financial information of the related party. However, in this last scenario, the accounting and documentation of the foreign entity should be available in Mexico.

Every year, taxpayers should file, jointly with the tax return or the audited financial statements, an informative tax return with the information on all operations performed in the previous fiscal year with non-Mexican resident related parties.

Derived from BEPS Action 13 since 2016, Mexico enacted in the Income Tax Law the obligation of filing the Master File, Local File, and CbCR, all of which must be filed no later than December 31 of the year immediately following the preceding fiscal year.

Tax audit procedure

Operations performed amongst related parties, as well as the TP method used, are disclosed in the annual tax return as well as in the informative tax return mentioned above. Likewise, in case of taxpayers who decide to audit their financial statements, the independent auditors report must also disclose and verify such operations.

The Mexican TAs are entitled to perform reviews on such transactions. For that matter, there is an international audit department within the Mexican TA, which is in charge of those assignments as well as to program the corresponding reviews. The Mexican TAs usually examine the adequateness of the intercompany TP only during a tax audit. Tax audits may cover periods of up to five years, and in such a case, the taxpayer is obligated to cooperate with the tax auditors.

As of 2017, Mexican TAs have been very proactive in reviewing related-party transactions carried out by multinational enterprises or groups, especially those concerning interest expenses, royalties, and cost sharing agreements.

Income adjustment, surcharges, and penalties

As previously mentioned, according to article 302 of the Regulations of the Income Tax Law, the ranges of prices, amount of compensation, or profit margins must be adjusted by application of the interquartile method. When the taxpayer's price, amount of compensation, or profit margin is out of the adjusted range, the price or amount of compensation should be adjusted to the median of the interquartile range.

If the adjustment on the income is made spontaneously, no penalties will be imposed to the taxpayer; only penalty interest. However, if the assessment or price adjustment is made on the income as a consequence of a tax audit, the Mexican TAs may impose penalty interest and a fine on the omitted tax.

Advance pricing agreements

In accordance to article 34-A of the Tax Code, taxpayers may request an APA. However, the procedure is complicated and uncertain. Usually, the Mexican TAs are reluctant to grant APAs, yet there are no duties or fees that should be paid to such. Role-back resolutions or agreements are not foreseen in the Mexican legal frame.

Ex post measures to prevent double taxation

Aside from a broad network of Tax Treaties, into which Mexico has entered, the Mexican Income Tax Law foresees both direct and indirect tax credits for burdens paid abroad. Regardless, when required, MAPs are followed to settle issues that lead to double taxation.

Intercompany financing

Interest payments made by a Mexican resident company on loans granted by a foreign related party are non-deductible for income tax purposes if the outstanding debt exceeds 3:1 debt over equity ratio.

Thin capitalisation rules in Mexico are not applicable to debts incurred for the construction, operation, or maintenance of productive infrastructure linked to strategic areas or electricity generation.

Regardless of the above, the terms of the finance contracts (interest rate, loan amounts, and payment deadlines, among others) shall be arranged based on the “arm’s length” principle.

Safe harbour provisions/exemptions for SMEs

Safe harbour provisions

Safe harbour rules only exist when dealing with “maquiladora” i.e., in bond-manufacturing entities which production is totally exported. In such case, a 6.9 percent return on assets or 6.5 percent return on costs and operating expenses is allowed.

Exemptions for SMEs

Taxpayers engaged in commercial activities whose revenue in the previous fiscal year did not exceed 13,000,000 Pesos and those which revenue derived from the rendering of professional services did not exceed 3,000,000 Pesos, shall not be bound to comply with any transfer pricing obligations.

TP and PEs (AOA)

There is no change expected on PE rules in the short term. However, the Mexican TA has signed on September 22, 2017 the MLI, which will bring modifications on PE actual regulation.

Contact information

For more information and TP related issues in Mexico, please contact:

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|------------------|-----------------------------------|
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Netherlands



Statutory rules/laws

- Netherlands Revenue. CIT Act, Articles 8b and 8c and Articles 29b – 29h.
- Dutch Regulations, rulings, guidelines:
 - TP Decree, November 14, 2013, IFZ 2013/184M
 - Decree on APAs, ATRs, Financial Service Companies, June 3, 2014, DGB 2014/296M
 - Decree on TP Coordination Group, August 11, 2004, DGB/1339
 - APA Decree, June 3, 2014, DGB 2014/3098
 - ATR Decree, June 3, 2014, DGB 2014/3099
 - Decree on Financial Service Companies, June 3, 2014, DGB 2014/3101
 - Q&A Decree re financial service companies, June 3, 2014, DGB 2014/3102
 - Decree on Attribution of Profits to Permanent Establishments, January 15, 2011 IFZ2010/457M
- Referred to as the “Netherlands TP Law/Rules/Regulations”

Definition of related party

The definition of related parties in article 8b CIT Act follows the wording of article 9 of the Model Treaty. Where an entity participates, directly or indirectly, in the management, control or capital of another entity, and conditions are made or imposed between these entities in their commercial and financial relations (i.e., the transfer price) which differ from conditions which would be made between independent parties, the profit of these entities will be determined as if the last mentioned conditions were made.

The first paragraph will also be applicable when the same person participates, directly or indirectly, in the management, control or capital of both the first and second entities.

Treatment of the OECD Guidelines

The OECD Guidelines are not part of the Dutch law. From a policy perspective, the Secretary of State is of the opinion that the OECD Guidelines intend to provide insight into the way in which the arm’s length principle must be applied in practice. In addition, the OECD Guidelines play a major role in an international context in relation to the application of Tax Treaties and prevention of double taxation.

Accepted TP methods and priority

In the Netherlands, the TAs use the OECD Guidelines which provide insight into the way in which the arm's length principle must be applied in practice. The regulation refers directly to the OECD Guidelines. Accordingly, the Dutch TAs accept the methods specified by the OECD Guidelines.

Nevertheless, There is no "best method" rule. The choice of the TP method is dependent on the facts and circumstances of the case.

Documentation requirements

a. Filing deadline

The general documentation requirement of article 8b-3 CIT Act has an 'open norm' (i.e., no specific documentation requirements for taxpayers), however, TPD should be part of the Dutch taxpayers' administration. There is no specific filing deadline, but, in general, TPD should be in place from the moment the intercompany transaction has taken place. Regular updates on the TPD is expected to account for normal business and market developments or with significant changes of facts and circumstances.

b. Mandatory language

There is no requirement that TPD should be prepared in a specific language (normally Dutch and English). However, TPD should be accessible to the TAs and, if not available in Dutch, the TAs could request for a translation.

c. Alignment with new Ch. V of OECD Guidelines/Action 13 of BEPS?

In 2016, new legislation has been introduced in the Netherlands as a consequence of the BEPS Project (art. 29b – 29h CIT Act).

The Netherlands legislation follows the OECD model legislation for CbCR requirements. The qualifying taxpayer must file the CbCR within one year after the closing of the fiscal year that is covered in the CbCR. CbCR may be filed in English or in Dutch.

A Master File and a Local File must be prepared by an MNE Group having a total consolidated group revenue of at least € 50 million in the fiscal year that immediately precedes the year for which a tax return is being filed. A Constituent Entity (from that MNE Group) that is subject to taxation in the Netherlands shall include in its accounts a Master File and a Local File for the year over which it is filing a corporate tax return within the period set for filing a corporate tax return. The Master File and Local File must be compiled in the Dutch or the English language.

Tax audit procedure

In general, there is no separate tax audit for TP. The risk of being audited by the Dutch TAs is considered moderate. However, if a company is being audited, TP issues are always investigated.

A tax audit should be announced in advance by the Dutch TAs, specifying the period concerned and the tax involved (i.e. corporate income tax, VAT, payroll). It is mandatory for a company to cooperate with the TAs, and the tax inspectors should have access to the office building. All requested information and intelligence should be given, and the tax inspector should have access to the business administration. Furthermore, all employees should be able to identify themselves.

In recent years, there has been a tendency towards a more enhanced co-operation between TAs and taxpayers in the Netherlands: Horizontal monitoring is based on mutual trust, understanding, and transparency between the taxpayers and the Dutch TAs. It aims at reducing administrative burdens and providing legal certainty in advance. Taxpayers need to have a solid Tax Control Framework.

Income adjustment, surcharges, and penalties

First, self-initiated adjustments on CIT returns are permitted as long as the adjustment relates to a fact that existed at book year-end and the final assessment has not been imposed yet.

Second, in case of evident shortcomings in the TPD, the risks of the company include:

1. Reversal of the burden of proof;
2. Potential penalties (no specific TP penalties exist) with a maximum of 100 percent;
3. Adjustments, including interest;
4. Double taxation;
5. Roll back period for adjustments of 5 years (12 years if the adjustment relates to foreign income).

Additional (higher) penalties could be imposed on the non-compliance with CbCR, especially in case of intentional non compliance.

Advance pricing agreements

The Dutch APA program is described in the APA Decree, June 26, 2014, DGB 2014/3098. One key objective is to provide taxpayers with a uniform and predictable APA/ATR practice with easy access, clear conditions, streamlined procedures and minimal processing time. The Netherlands provides taxpayers certainty in advance if:

- The company or its affiliates conduct operational activities in the Netherlands (including concrete plans to do so); or
- The company meets specified minimum substance requirements for (intermediary) holding companies and intragroup financing, licensing and leasing companies.

Ex post measures to prevent double taxation

On June 7, 2017, The Netherlands signed into the MLI.

The Netherlands submitted a list of 82 Tax Treaties entered into by the Netherlands and other jurisdictions that the Netherlands would like to designate as Covered Tax Agreements (CTAs), i.e., Tax Treaties to be amended through the MLI. Together with the list of CTAs, the Netherlands also submitted a provisional list of reservations and notifications (MLI positions) in respect of the various provisions of the MLI. The definitive MLI positions will be provided upon the deposit of its instrument of ratification, acceptance or approval of the MLI.

The Netherlands has chosen to apply almost all articles included in the MLI to the CTAs that are in scope. It made a reservation to not apply Article 11, which contains a so-called “saving clause” that clarifies that a treaty does not restrict a jurisdiction’s right to tax its own residents, except with respect to certain treaty provisions.

The most important changes that will affect all of the submitted Dutch CTAs relate to the introduction of a principal purpose test (“PPT”) and an amendment of the preamble that states that the relevant Tax Treaty is not intended to create opportunities for non-taxation or reduced taxation.

The ratification of the MLI is expected in 2018.

Intercompany financing

Debt v. equity

In general, interest payments made by a Dutch corporate taxpayer are deductible from its taxable income. However, it should be determined whether a loan is considered as a debt or that it should be considered as equity for Dutch tax purposes.

According to the Dutch Supreme Court, debt can be re-characterised into equity, if the loan is considered to be a ‘sham loan’, a ‘loss financing’ or a ‘participating loan’.

Statutory limitations on interest deductions

If the loan is indeed debt, the interest deduction can be denied on the basis of a number of statutory restrictions in the CIT Act.

1. Article 10-1-d CIT Act provides that the remuneration on a loan is not deductible if the loan is granted under such circumstances that the loan in fact functions as equity (a “hybrid loan”, determined in accordance with the abovementioned case law).
2. Based on article 10a-1 CIT Act the deduction of interest – currency results and other costs included – paid or accrued on debt attracted by the taxpayer directly or indirectly – legally or de facto – from a related party, is denied if the loan is attracted directly or indirectly – legally or de facto – in connection with certain categories of tainted transactions.
3. Article 10b CIT Act restricts the deductibility of interest and value mutations of loans due to a related party of the taxpayer if the loan (i) has no fixed maturity or a term of more than 10 years; and (ii) is interest-free or carries an interest rate substantially (i.e. >30 percent) below arm’s length interest rate.
4. Article 13l CIT Act restricts the deduction of ‘excessive’ interest on debt of Dutch corporate taxpayers that have invested in exempt participations.
5. Based on article 15ad CIT Act the interest – currency results and other costs included – on certain ‘excessive’ acquisition debt cannot be deducted from the taxable profits attributable to a Dutch target company.

Case law limitations on interest deductions

If the interest deduction is not restricted on the basis of the case law described above or the statutory provisions in the CIT Act, the deduction can nevertheless be denied on the basis of the Dutch abuse-of-law concept of *fraus legis* or if the loan is considered to be a non-business-like loan.

Safe harbour provisions/exemptions for SMEs

To simplify the process for small taxpayers, a small-business taxpayer APA is available; in such cases the TAs assist the taxpayer to find comparables. To qualify as SME, two of the three following criteria should be met:

- Total value of assets is not more than € 6,000,000;
- Total net turnover in financial year is not more than € 12,000,000;
- Average number of employees during financial year is not more than 50

TP and PEs (AOA)

The Dutch legislation, regulations, rulings, and guidelines adopts the AOA: The profits to be attributed to a PE are the profits the PE would have earned at arm's length (functionally separate entity approach) and is therefore based on TP.

Contact information

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New Zealand



Statutory rules/laws

- Sections GC 6 – GC 14 of the Income Tax Act 2007 (“ITA 2007”) and double tax agreements.
- Referred to as the “New Zealand TP Regulations”

Definition of related party

The associated party rules in New Zealand are complex. The term “associated party” is defined in sub part YB of ITA 2007. In summary, the following applies:

- Two companies are associated if a group of persons exists whose total voting interests in each company is 50 percent or more.
- A company and a person other than a company are associated if the person has a voting interest of 25 percent or more in the company.
- There is also a tripartite test which associates two persons if they are each associated with the same third person under a different test

Treatment of the OECD Guidelines

Inland Revenue (New Zealand’s TA) fully endorses and generally follows the OECD Guidelines when administering New Zealand’s TP rules. However, Inland Revenue has reserved its position on Article 7 of the Model Treaty, which relates to branches. Inland Revenue supports the single-entity concept rather than the separate legal entity concept adopted by other jurisdictions.

Accepted TP methods and priority

There is no set hierarchy of preferred methods in the legislation or the TP guidelines. All of the methods outlined in Chapter II of the OECD Guidelines are acceptable. The use of the CUP or Cost Plus is preferred as these provide the most reliable comparables. However, due to the lack of data available, the TNMM is regularly used. New Zealand is a small market with little comparable data. Therefore, data from Australia, the UK, or North America is frequently used as these markets are the most comparable to the New Zealand’s market.

Documentation requirements

a. Filing deadline

There is no statutory requirement for a taxpayer to maintain TP documentation. However, Inland Revenue expects a taxpayer to be able to support the prices used in its associated party cross-border transactions. Preparing TP documentation shifts the burden of proof to Inland Revenue to prove that the prices used are not at an arm's length rate.

b. Mandatory language

Although there are no formal language requirements, English is used in practice.

c. Alignment with new Ch. V of OECD Guidelines/Action 13 of BEPS?

Inland Revenue has issued guidance as to what should be included in the documentation which must be relevant to the New Zealand entity. Good documentation packages should include the following:

- a detailed discussion of the facts (analysis of functions, risks and assets – especially intangibles);
- industry analysis (to put the taxpayer's facts in the context of its industry), especially identifying the key profit drivers, performance of major competitors, and where the value added arises for the company;
- careful consideration of associated party transactions (each category should be examined separately);
- a discussion as to the efforts made to find internal comparables;
- reasoning as to the selection of the best pricing method available;
- full details as to the comparables search undertaken (database utilised, criteria employed, accept/reject list including reasons for rejection);
- a cross-check using at least a second profit level indicator;
- conclusions, including sanity checks to demonstrate commercial realism; and
- copies of all inter-company agreements as well as the local and global corporate structures.

Tax audit procedure

The New Zealand TA usually examines the adequateness of intercompany TP only during risk reviews or tax audits. Tax audits are undertaken at the discretion of Inland Revenue and targets are selected based on certain criteria, such as low profitability or losses, industry performance, and transaction types (eg financing). Typically, most large companies can expect to be audited every 5 years.

Risk Assessment Review questionnaires relating to TP and thin-capitalisation are typically issued to companies during general income tax audits or risk reviews and as part of Inland Revenue's specific TP review process. The questionnaires request detailed information including financial details of the New Zealand taxpayer and consolidated group, types and values of related party transactions, methodologies used, details of any business restructures and whether TP documentation has been prepared.

TP documentation for all types of transactions must only be submitted upon request of Inland Revenue. Normally, Inland Revenue specifies a due date for the documentation to be provided. This is generally at least 28 days from receipt of the information request. Deadlines may be extended by negotiation.

If an adjustment is proposed by Inland Revenue, it can be disputed by following a prescribed process which includes a number of steps. The process can be finalised at any stage if both parties agree. The process is as follows:

- Inland Revenue issues a notice of proposed adjustment to the taxpayer, which has to be responded to by the taxpayer within two months of issue. If no response is received, the assessment will stand;
- A meeting between the taxpayer and Inland Revenue;
- Disclosure notice is issued by Inland Revenue;
- Adjudication and review; and
- Litigation if no agreement is reached.

Income adjustment, surcharges, and penalties

There are no specific TP penalties. Inland Revenue can apply the general tax penalties under sections 141 A-K of the Tax Administration Act 1994, which range from 20 percent to 40 percent, depending on the nature of the adjustment as follows:

- 20 percent penalty for not taking reasonable care
- 20 percent penalty for an unacceptable position
- 40 percent penalty for gross carelessness
- 100 percent penalty for an abusive tax position
- 150 percent penalty for an evasive or similar act

Shortfall penalties may be reduced upon voluntary disclosure to the Commissioner of the details of the shortfall:

- If the disclosure occurs before notification of an investigation, the penalty may be reduced by 100 percent (only for lack of reasonable care or unacceptable tax position categories) or 75 percent for other shortfall penalties
- If disclosure occurs after notification of an investigation, but before the investigation commences, the penalty may be reduced by 40 percent

Shortfall penalties may be reduced by a further 50 percent if a taxpayer has a past record of “good behaviour.”

Advance pricing agreements

Section 91E of the Tax Administration Act 1994 allows for Inland Revenue to issue an APA in the form of a binding ruling. A unilateral APA will be issued in the form of a binding ruling and bilateral/multilateral APAs may be entered to follow New Zealand’s Tax Treaties. During the application process the TP principal advisors from Inland Revenue will discuss any issues with the taxpayer to facilitate the process. The time for obtaining a unilateral APA is typically 6 months from receipt of a completed application.

The filing fee for application is NZD 322, and Inland Revenue does not charge for its time incurred dealing with the application.

Ex post measures to prevent double taxation

New Zealand signed the MLI on 7 June 2017. New Zealand has not reserved on the MLI articles relating to the amended definition of PEs and, therefore, has adopted these articles. Consultation is currently underway on unilateral options to counter the avoidance of PE issues.

Intercompany financing

The New Zealand Transfer Pricing Regulations do not specify a method for evaluating the arm's length nature of interest rates.

As a general rule, all financial services transfer pricing revolves around CUPs, observable market prices, plus adjustments to render the prices more comparable to the controlled transactions. With regards to loans, for example, the "arm's length rate of interest" is a rate that would have been charged at the time the indebtedness arose in independent transactions with unrelated parties under similar circumstances, including the credit worthiness of the borrower; principal amount of the loan; duration of the loan; security involved; and the interest rates of comparable loans.

Determination of debt v. equity

This is covered by the thin capitalisation rules contained in subpart FE of ITA 2007 and are complex. The basic debt to equity safe harbour is 60 percent.

Arm's length interest rate

Most interest rate analyses begin with an appropriate reference rate or base indicator. For variable rate loans, this is typically the bank bill rate; for fixed rate loans, usually swap rates are applicable. Financing is mostly about margins. The key factor in determining interest rate margins is credit risk or the probability of default (which includes term to maturity). Factors such as liquidity, ranking (senior or subordinated) and early repayment have only limited impact compared with credit risk. Thus, the margin added to the base indicator in order to arrive at an interest rate is almost entirely compensation for credit risk.

Deductibility of interest

Interest expenses are generally deductible. However, if the thin capitalisation safe harbour thresholds are breached then the deductible amount is restricted. These provisions are contained in subpart FE of ITA 2007. In general, if the debt to equity ratio of the borrower exceeds 60 percent then the interest deduction will be restricted. There are other considerations/thresholds to be taken in to account.

Loan write off treatment

Generally, a loan write off is considered to be income of the borrower. However, exemptions may apply.

Safe harbour provisions/exemptions for SMEs

Inland Revenue provides several options for SMEs to reduce the administrative burden, with regards to the topics below:

Interest rates

For small value loans (ie, for cross-border associated party loans by groups of companies for up to NZD 10 million principal in total per year), Inland Revenue currently considers 250 basis points (2.5 percent) over the relevant base indicator is broadly indicative of an arm's length rate, in the absence of a readily available market rate for a debt instrument with similar terms and risk characteristics. This margin is reviewed on a regular basis and updated accordingly. The next review will be 30 June 2018.

Administrative expenses

Inland Revenue has issued a de minimis threshold for certain administrative services as detailed in paragraphs 559, 561, and Table 8 of the October 2000 TP Guidelines (Tax Information Bulletin: Vol 12, No 10 (October 2000) – Appendix). These are non-core services and refer to activities that are not integral to the profit-earning or economically significant activities of the group. They include activities that are supportive of the group's main business and are generally routine but are not similar to activities by which the group derives its revenue. The de minimis limit is NZD \$1 million of this type of expense per year and an acceptable mark-up is on average 7.5 percent but it can be between 5 percent and 10 percent depending on the services and whether the services are being supplied to or by the New Zealand taxpayer.

TP and PEs (AOA)

There is some uncertainty as to how this will be treated in New Zealand, and Inland Revenue is considering its policy on this matter. Guidance in the area of branch profit attribution is urgently needed as Inland Revenue has made an explicit reservation against AOA.

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Poland



Statutory rules/laws

- Law of February 15, 1992 on CIT No 21, item. 86 (“CIT Law”)
- Ordinance of the Minister of Finance of 10 September 2009 on the Mode and Procedure of Determining the Natural Persons’s income by Way of Assessment and on the Mode and Procedure of Elimination of Double Taxation of Legal Persons in Case of Adjustment of Profits of Associated Enterprises (Journal of Laws No. 2014.1176). (“TP Ordinance”)

Definition of related party

Pursuant to the CIT and PIT (Personal Income Tax) Laws, relationships occur when a natural person, legal entity or organisational unit without legal personality participates directly or indirectly in the management or control of an enterprise or holds a share in the capital of that enterprise. These regulations apply to entities domiciled or managed on the territory of Poland (domestic entities) and those domiciled or managed outside of Poland (foreign entities) if they are related to domestic entities. Holding a share in the capital of another entity referred to in this provision means a situation where an entity holds directly or indirectly not less than 25 percent of the capital of another entity.

Treatment of the OECD Guidelines

Poland has adopted most of the provisions resulting from the OECD BEPS Action Plan, among others the BEPS Action 13 on the requirement of three-stage documentation containing the EU and OECD recommendations.

Accepted TP methods and priority

Polish tax law adopts the OECD Guidelines’ methods that may be used to determine the price of intra group transaction.

While applying the TP methods, particular attention should be paid to the provisions of § 6 of the TP Ordinance relating to the comparability analysis. The most important aspect of pricing/margins of transactions with related party is to identify them in relation to the external market. In practice, a related entity, when determining the terms of a transaction with another related entity, has to refer to the conditions of similar transactions with an independent entity (a so-called internal comparison) or to similar transactions concluded by independent entities (a so-called external comparison).

Documentation requirements

TPD should include the following items:

1. Description of transaction or other events;
2. Analysis of comparative data;

3. Description of financial data;
4. Information about taxpayer;
5. Additional documents.
6. Tax Audit Procedure

According to the Polish TP regulations, the taxpayer is obliged to determine whether TPD is obligatory. In each case, the corporate taxpayer is obliged to indicate in the annual income tax declaration CIT-8 whether he/she is obliged to prepare TPD or not. If the taxpayer is obliged to prepare TPD, he/she must make an appropriate statement to the Tax Office. Depending on income, the taxpayer is required to submit the additional declarations CIT TP and CIT CbCR. Similar documents should be submitted if the taxpayer is subject to PIT (natural person).

Income adjustment, surcharges, and penalties

The absence of the required TPD can result in a 50 percent penalty tax rate imposed on the difference between the income declared by the taxpayer and the income assessed by the TA.

a. Fiscal penal code

Tax penalties and criminal prosecutions:

- Failure to prepare TPD for the given year may result in a penalty amounting up to PLN 6.4 million.
- Failure to submit the required TPD within 7 days from the date of request may result in a penalty up to PLN 19.2 million.
- The legislator provides for penalties not only for failure to prepare or to submit the required TPD but also for its incomplete, incorrect, or unreliable content. This penalty may amount up to PLN 19.2 million.

b. Criminal code

Criminal penalties:

- A penalty payment amounting from 1 percent to 8 percent of the income.
- Imprisonment for up to 10 years.

Advance pricing agreements

Starting from March 1, 2017, the decisions on the APA are issued by the Head of National Fiscal Administration ("KAS"). The conclusion of the APA with the Polish TA is the most effective way to protect the company against the risk of questioning the pricing mechanism that the company has adopted. The APA is issued for a maximum of 5 years. At the end of this period, it is possible to extend the agreed provisions.

The fee for the APA is 1 percent of the transaction value covered by the APA. The fee varies depending on the variant of the APA (unilateral for domestic entities, referring to foreign entities or bilateral/multilateral), but it cannot be lower than PLN 5,000 (approx. €1,190) or higher than PLN 200,000 (approx. €47,619).

The fees for renewal of APAs are half of the amount of the initial fee.

Ex post measures to prevent double taxation

Poland has concluded 93 Tax Treaties to date and has introduced the provisions of “corresponding adjustment” in TP into its laws on the income tax and through the Ordinances of the Minister of Finance of September 2009 (Journal of Laws No. 2009.160.1267 and 1268). Chapter 7 of these Ordinances deals with the principle of eliminating double taxation in case of adjustment of profits between related parties in cross-border transactions. It contains the information on the formal requirements for submitting and examining the application, the procedure, and the time limits for consideration of the matter by way of agreement between the taxpayer, the Ministry of Finance, and the foreign CAs. At the same time, the regulation provides a general opportunity to make an adjustment of tax liabilities in order to eliminate double taxation suffered by related companies.

Moreover, in order to induce the state to agree on the corresponding adjustment the entities can refer to international instruments. Polish taxpayers can use the arbitration procedure under the Arbitration Convention 90/436/EEC. Another option is MAP, as provided for in the Tax Treaties based on the Model Treaty.

The disadvantage of the international solutions is that they do not apply to the elimination of double taxation of the transactions between domestic entities. In this case, it is advisable to apply for APA.

Intercompany financing

Receiving an intercompany loan may involve the obligation to prepare TPD (if the amount of the loan exceeds specified limits). It should be noted that the terms and conditions of the financing have to correspond to market conditions. The regulations on TP do not apply to written off loans.

Safe harbour provisions/exemptions for SMEs

The Polish legislator has not introduced the provisions on the institution of “safe harbour” for SMEs.

TP and PEs (AOA)

As of now, Poland has not introduced BEPS Action 7 into its legislation.

Contact information

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Portugal



Statutory rules/laws

- Article 63.º of the Portuguese CIT Code (“Article 63.º”)
- General Guidance on TP – Ministerial order (Portaria) nr. 1446-C/2001, dated December 21, 2011.
- Report on the Use of Comparables in the EU, im March 2017, from JTPF. Portugal is a member of the EU JTP Forum.

Definition of related party

The term “related party” is defined in paragraph 4 of Article 63.º of the Portuguese Code.

It is considered that there are special relations between two entities in situations in which one has the power to exercise, directly or indirectly, a significant influence on the management decisions of the other, which is considered, among other things, between:

- a. An entity and the owners of its capital, or the spouses, ascendants or descendants of the latter, holding, directly or indirectly, a participation of not less than 20 percent of the capital or voting rights;
- b. Entities in which the same owners of capital, their respective spouses, ascendants or descendants hold, directly or indirectly, a participation of not less than 20 percent of the capital or the voting rights
- c. An entity and the members of its governing bodies, or any administrative, management, or supervisory bodies, and their spouses, ascendants and descendants;
- d. Entities in which the majority of the members of the governing bodies, or of the members of any administrative, management, or supervisory body, are the same persons or, being different persons, are connected by marriage, legally recognised partnership or kinship in a straight line;
- e. Entities related under a subordination agreement or any other agreement of a similar nature;
- f. Companies that are in a controlling relationship, according to Article 486.º of the Commercial Companies Code;
- g. Entities whose legal relationship, by its terms and conditions, may influence management decisions of the other, depending on facts or unrelated to the business or professional relationship circumstances;
- h. A resident or non-resident entity with a PE located in Portuguese territory and an entity subject to a clearly more favorable tax regime resident in a country, territory or region included in the list approved by the Minister of Finance.

For the purposes of calculating the percentage level of indirect participation in the capital or voting rights referred above, in the situations in which there are no special rules defined, the criteria used is paragraph 2 of Article 483.º of the Commercial Companies Code.

From 2014 onwards (under Act 2/2014, 16 January), the following was also considered as related entities:

- a.* A non residente entity in Portugal and its PE in Portugal, as well as the relations of its PE in Portugal and other PEs of the same entity in other countries/territories;
- b.* An entity resident in Portugal for tax purposes and its PEs located in other countries/territories.

The cost allocation tends to be unacceptable – Therefore, from 2014 onwards, the Portuguese PE and its head office must relate and conclude transactions at “arm’s length”.

A TP file must also be prepared and kept at the PE’s premises until so required by the PTA.

Treatment of the OECD Guidelines

The Portuguese TP law adopted the OECD Guidelines. The TP methods outlined in Chapter II of the OECD Guidelines are accepted by Portuguese Tax Authorities (“PTA”).

Portuguese legislation, on what concerns TP, applies both to domestic and foreign transactions between related parties, i.e., applies to the transactions concluded by a Portuguese taxpayer and its related party, either located in Portugal or abroad.

Portugal is a member of the EU JTP Forum, as part of its work programme for 2015/2019 (“Tools for the rules”), addresses the use of comparables in the EU. Therefore, Portugal is naturally subject to its findings, rules and considerations, namely:

“In March 2017, the EU JTP Forum agreed on the “Report on the Use of Comparables in the EU” (the “Report”). The Report establishes best practices and pragmatic solutions by issuing various recommendations for both taxpayers and tax administrations in the EU and aims at increasing in practice the objectivity and transparency of comparable searches for transfer pricing.”

Accepted TP methods and priority

The PTA adopts the TP methods specified by the OECD Guidelines. Additionally, when the methods specified by the OECD Guidelines cannot be applied, or where their use would not provide a more reliable measure of the terms and conditions that independent entities normally agree, accept, or practice, **Different methods are accepted to justify different transactions/functions**. The PTA, in accordance with OECD Guidelines, accepts the application of a different method for different functions/transactions of the same entity.

The PTA prefers local comparables (i.e., Portuguese and, to a certain extent, Spanish), but others may be allowed whenever these are not available. If a pan-European search is used, it is expected that the PTA will screen the Portuguese comparables in the rejected list and possibly create a subset of Portuguese final comparables.

The PTA uses SABI (with Iberian companies) and Amadeus (with European companies) databases. They prefer Portuguese (or Iberian) independent comparables, regardless of the database. Other databases are accepted by the PTA for specific categories of transactions or industries.

Documentation requirements

Taxpayers whose net sales and other operating incomes exceed the amount of €3 million in the previous year must prepare and maintain an annual TPD (i.e., BEPS Action 13 Local File), which must be prepared by the 15th day of the seventh month following the end of the tax year.

Taxpayers must declare at the Annual Accounting and Fiscal Declaration “declaração anual de informação contabilística e fiscal”, foreseen in article 121 CIT, the transactions concluded with related parties, identifying:

- i. the entities involved;
- ii. the amounts involved;
- iii. the preparation of the respective TP file and the local where it is kept.

Tax adjustments to CIT Declaration of the year – In case where the taxpayer enters into commercial relations/transactions with its related parties not at arm’s length, the taxpayer must make the respective adjustment at its CIT Declaration.

a. Filing deadline

The TPD must be submitted upon request.

b. Mandatory language

According to the Portuguese legislation, the documentation must be provided in Portuguese. After requesting prior approval, documentation in English is also accepted.

c. Alignment with new Ch. V of OECD Guidelines/Action 13 of BEPS?

After requesting prior approval, the PTA may accept the BEPS Action 13 Master File.

Tax audit procedure

Tax assessment for 4 years, in general – In Portugal, tax assessment is possible for the four years after the end of the assessment year.

Keep documentation for 10 years – All Portugal based companies have a statutory obligation to keep their TPD for the relevant year for a 10-year period available (at the Portuguese establishment or premises) and in good order.

Present documentation upon request – Once requested by the PTA, the taxpayer has usually 10 days to deliver the TPD.

The PTA examines the adequateness of intercompany TP only during a tax audit. In case of a tax audit, the taxpayer is generally obliged to cooperate with the tax auditors.

Income adjustment, surcharges, and penalties

- **Tax assessments may be issued, in general, within a 4-year period** following the last day of the tax year concerned.
- **Tax assessment is also possible for a 12 year period** – for undeclared income obtained from countries or territories with clearly more favourable tax regimes.
- **Prescription of tax debts in 8 years** – On what concerns tax debts (taxes fully liquidated and charged to taxpayers) prescription occurs in 8 years, being 15 years in respect to taxes related to entities located in countries or territories with a more favorable tax regimes.
- **Under a tax assessment, adjustments may be made:**
 - **Automatic tax adjustments** – Where TP provisions apply to transactions between two entities that are both liable to CIT (in Portugal), automatic adjustment, made by the PTA, to the taxable income of one entity should be reflected by a corresponding adjustment to the taxable income of the other entity.
 - When the adjustments affect transactions between a Portuguese taxpayer and a non resident entity, the mechanisms provided for in the relevant Tax Treaty should apply and corresponding adjustments may be made by means of a CA procedure.

EC Directive on the elimination of double taxation (EC Directive 90/436/CEE) may also be applicable at the taxpayer's request.

Please also note the below mentioned in respect to Exchange of Information in APA, within EU countries.

a. Estimation of tax base

- If the taxpayer does not submit its TPD, or
- the submitted documentation is substantially unusable, or
- it is determined that the taxpayer has not prepared the documentation contemporarily for extraordinary transactions,

It is disputably assumed that the domestic income of the taxpayer exceeds its declared income. In such case, the PTA is entitled to estimate the domestic taxable income of the taxpayer.

b. Surcharges and penalties

If the taxpayer:

- Submits TPD beyond the deadline established by the PTA, a penalty of €500,00 to €10.000,00 shall be applicable, plus 5 percent per each day of delay (Act no. 98/2017, 24 August).
- Provides incorrect/misleading documentation, a penalty up to €22.500,00 may be charged;
- Refuses to submit TPD, a penalty up to €75.000,00 may be charged.

Advance pricing agreements

- Advance Pricing Agreements (“APA”) – Decree-Ruling 620-A/2008 dated July 16, 2008.
- Exchange information on APA – Act 98/2017, 24 August, and Directive (UE) 2015/2376, of EU Council, of 8 de decembre 2015, e (UE) 2016/881, of Counsel, of 25 May 2016.

An APA program is included in the Portuguese CIT Code (Article 138.º). Ministerial Order 620-A/2008 allows taxpayers to negotiate the following types of APAs:

- Unilateral – when the parties of the agreement are the PTA and one or more taxpayers of Individual Income Tax (IRS) or Corporate Income Tax (IRC) that are mentioned in Article 2.º of the Ministerial Order.
- Bilateral or Multilateral – besides entering into an agreement between PTA or IRS and IRC taxpayers, the taxpayer has also signed an agreement with one or several TAs, under the MAP predicted in a convention, intended to avoid double taxation automática de informações obrigatória relativa a decisões fiscais prévias transfronteiriças e a acordos prévios sobre preços de transferência e no domínio da fiscalidade. on income taxes.

Exchange of information under APA – Since 25 August 2017, under Act no. 98/2017, of 24 August, the Automatic Exchange of information regarding decisions on Advance Pricing Agreements and other Tax Information is in force in Portugal. Directive (UE) 2015/2376, of EU Council, of 8 de decembre 2015, e (UE) 2016/881, of Counsel, of 25 May 2016. Also see (Portuguese Decree-Law no. 61/2013, of 10th May).

Portuguese legal timeframe foresees the following phases:

- Pre-filing phase – a preliminary evaluation of the initial taxpayer proposal and may comprise of joint meetings with the tax authorities.
- Submission phase – analysis and negotiation of the APA proposal, which in any case should be presented at least 180 days in advance to the applicable tax year. The PTA's timeframe to evaluate the content of an APA proposal amounts to 180 days in the case of unilateral agreements, and extends to a 360 days period in case of bilateral/multilateral agreements.

APAs may not exceed a three-year period, which may be renewable upon written request to the PTA.

An APA is subject to a filing fee ranging from €3.150,00 to €35.000,00 paid to the PTA, depending on the taxpayer's average turnover (fees are reduced by 50 percent for renewals or revisions of existing APAs).

The PTA does not disclose information on APAs submitted or concluded. Nevertheless, please bear in mind that it is mandatory the exchange of information between TAs of EU Member States or with TAs from other countries that signed the abovementioned Directive.

Ex post Measures to prevent double taxation

- Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting, signed in June 2017.

Portugal signed, the MLI on 7 June 2017. The MLI modifies the application of thousands of bilateral Tax Treaties concluded to eliminate double taxation. It also implements agreed minimum standards to counter treaty abuse and to improve dispute resolution mechanisms, while providing flexibility to accommodate specific tax treaty policies.

As mentioned above, Portugal is also a member of the EU JTP Forum, and is extremely involved in prevention of BEPS and accomplishing all OECD rules, as well as the recommendations regarding TP issues.

Intercompany financing

a. Debt v equity

In 2013, thin capitalisation rules were replaced by earnings stripping rules. Under the earning stripping rules currently in force, interest is deductible up to the higher of the following amounts:

- i. €1 million or 30 percent of the taxable EBITDA. However, a transitional period applies, under which the EBITDA threshold will be gradually reduced from 70 percent in 2013 to 30 percent in 2017;
- ii. The interest which, during a certain period, exceeds the abovementioned limits and therefore is not deductible for tax purposes may be carried forward for the five subsequent periods. The full amount of interest deductible in each of the subsequent periods may not exceed the said limits.

b. Interest rate – determined by law

No fixed interest rate – The Portuguese law does not establish any fixed interest rate to be adopted on financing by related parties in cases where TP legislation applies (Article 63.º). Therefore, interest rate shall be determined under terms and conditions normally agreed between independent parties on comparable operations.

Interests on financing from related parties are not deductible when exceeding the above referred amounts (€1 million or 30 percent EBITDA).

Curiosity – However, for domestic shareholder’s loans in cases not subject to TP legislation there is an interest rate recommended – Euribor 12 months plus 2 percent (Portaria 279/2014 30 December.) In these cases, taxpayers may not deduct interests paid to its shareholders in the amounts exceeding the legal interest rate.

Safe harbour provisions/exemptions for SMEs

In Portugal, SMEs are ruled by Decree-Law 372/2007, 6 November, and Recommendation 2003/361/CE.

SMEs are in characterised by the number of employees and the volume of sales. SMEs are entities with no more than 250 employees, and:

- i. A volume of sales not exceeding €50 million, or
- ii. A balance at the end of the year, not exceeding €43 million.

Small enterprises are those with less than 50 employees, and a volume of sales, or total balance, not exceeding €10 million.

So far, SMEs are allowed a deduction to CIT (“colecta”) up to €5 million of dividends reinvested within the company, with the limit of 25 percent of CIT due.

Proposal for State Budget for 2018 (still subject to approval): SMEs will be able to deduct CIT (“dedução à colecta”) an amount up to €7,5 million of dividends that are reinvested in the company, also limited to 25 percent of the CIT (“colecta”).

TP and PEs (AOA)

As mentioned above, in 2014 according to the Arm's length OECD Approach, the following entities were considered related entities for the application of TP legislation:

- a.* A non resident entity in Portugal and its PE in Portugal, as well as the relations of its PE in Portugal and other PEs of the same entity in other countries/territories;
- b.* An entity resident in Portugal for tax purposes and its PEs located in other countries/territories.

Therefore, the allocation of profits to a PE located in Portugal, by its head office located abroad may not be at cost (cost allocation), but at arm's length. From 2014 onwards, Portuguese PE and its head office must relate and conclude transactions at "arm's length" (justified by one of the methods), and a TP File must be prepared and kept, until duly required by the PTA. This also applies to two different PEs of related entities with resident abroad.

Since January 2014, PEs have been treated as separate entities from their head offices abroad and therefore, for TP purposes, PEs are regarded related to their head office and therefore subject to TP legislation.

TP rules apply both to Portuguese resident entities as well as to PEs of non-resident entities and their head office, as well as, to relations between PEs located in Portugal of two related entities located abroad.

Other topics

The PTA is more and more involved and concerned with TP orientations/legislation, working teams, forums, etc. Tax audits in TP increased from 2015 up to date significantly.

However, there are still a few Supreme Court decisions regarding the application of TP rules, and even fewer on what concerns the recent implemented legislation, therefore it is still difficult to say what is the position of the PTA regarding the TP policies adopted by Portuguese taxpayers, as well as, what is the interpretation of the Supreme Court on the main TP rules.

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Russia



Statutory rules/laws

- Chapters 14.1-14.6 (Articles 105.1-105.25) of the Russian Tax Code("RTC")

Definition of related party

For TP purposes, taxpayers are considered related parties when they are "owned or controlled directly or indirectly by the same interests." Control may include voting power, the right to appoint the majority of members of management, and the basis of contractual arrangements.

Courts also have the right to recognise parties related for reasons other than those stipulated in the RTC if the relationship between the parties may have an impact on the conditions and outcome of a transaction performed by these parties or the results of their economic activity.

Treatment of the OECD Guidelines

The OECD Guidelines are not officially implemented. In some cases, taxpayers use OECD Guidelines approaches (especially in deals with the use of intangible assets or intercompany services because of the absence of detailed explanation in Russian TP legislation). However, there are some major differences between Russian TP rules and OECD Guidelines:

- Financial thresholds;
- Interdependence is based on >25 percent ownership criterion;
- Approach to calculation/definition of the market range;
- Comparable analysis.

Accepted TP methods and priority

The TP methods specified in the RTC are similar to the methods specified in the OECD Guidelines. The rules contain the best-method rule. The CUP Method remains the primary TP method to be used (except for the resale transactions, where the RPM will be preferable). If the best methods are not applicable, the taxpayer is free to choose between the remaining methods, although the PSM should be used as 'the method of the last resort'.

In the case where a specified TP method (or combination of) cannot be applied, the market price can be proven with a self-made method or with an independent appraisal report.

Documentation requirements

Russian Federal Tax Service has published Letter No. OA-4-13/14433 of 30 August 2012 (“the Letter”) on preparing and filing documents for tax control purposes. The Letter explains the rules governing preparation of TPD, specifically which transactions require documentation, level of detail, filing deadlines, archiving period, and other related information.

Taxpayers are required to present TPD within 30 days of receiving such request from the Russian TA. In case the taxpayer has prepared the TPD in a timely manner, the Russian TA will relieve the taxpayer from the penalty in the case accrual of additional tax.

The Russian State Duma is considering a bill that requires the provision of a three-tier TPD that will comply with the requirements of BEPS Action 13. Moreover, taxpayers will have a possibility to provide documentation in English (as of today – TPD should be provided in Russian). It is expected that the law will be approved by the Russian Government before the end of 2017.

Tax audit procedure

Special TP audits are performed by article 105.17 of the RTC. In General, the decision about conducting the TP audit could be made no later than two years from the date of receipt of the notification, and local tax offices are not allowed to conduct TP audit.

Taxpayers will be required to present TPD within 30 working days of receiving a TA's request.

Some reasons for executing TP audits include:

- Notification of the taxpayer on the controlled transactions;
- Identification of a controlled transaction as the result of a tax audit.

The Federal Tax Service of Russia (“RFTS”), during the tax audit, applies the TP method (or combination of methods) applied by the taxpayer.

The use of a different method (or combination of methods) is possible if the RFTS proves that the method (or combination of methods) applied by the taxpayer does not allow to determine the comparability of the commercial and financial conditions of the controlled transaction with the terms of the comparable transactions between independent companies.

During TP audits, the Russian TA has the right to request information from both parties of a controlled transaction. Under ordinary circumstances, a TP audit should last no longer than six months, but, in certain cases, it can be extended up to 21 months (e.g. extensions may be necessary if information from foreign TAs is requested or there is a need to involve an expert, etc.).

Income adjustment, surcharges, and penalties

The Russian TA is allowed to make TP adjustments in relation to:

- Corporate profits tax;
- Individual income tax (for individual entrepreneurs);
- Mineral extraction tax (if goods are subject to the above tax at a percentage rate);
- VAT (if the counterparty is exempt from Russian VAT or is not a VAT taxpayer in Russia).

The tax authorities are entitled to adjust prices for tax purposes if the price applied in a controlled transaction or its profitability is not within the determined market range of prices (profitability).

The Russian TA may charge additional tax and late payment interest on underpaid tax. Late payment interest should be charged in accordance with the general rules at a rate of 1/300 of the Central Bank of Russia refinancing rate (e.g., on 29 September 2017 this rate is set as 8.5 percent per year).

Penalties for applying prices that do not comply with the arm's length principle:

- Up to 40 percent of additionally accrued amount of tax, but not less than RUB 30,000 (approximately USD 526).
- For a transition period a lower penalty of 20 percent of additionally accrued amount of tax applies (for 2014–2016 tax periods), but not less than RUB 30,000.

The untimely submission of a TP notification form, or its inaccurate completion, may result a penalty of RUB 5,000 (approximately USD 86). There may be a criminal liability charged to the general director and the chief accountant of a Russian entity for tax evasion in significant amounts.

Advance pricing agreements

APAs are available only for 'large taxpayers'. The general qualification criterion for a 'large taxpayer' varies depending on the level (federal or regional) at which such taxpayer is subject to tax administration. A taxpayer is generally considered a 'large taxpayer' at the regional level if any of the following criteria is met:

- Total amount of annual federal taxes equals RUB 1 billion (USD18 million); or
- Total annual revenue equals RUB 1 billion to RUB 20 billion (USD 18 – 347 million.) (amendment of Federal Tax Service dated 24 April 2012) of Federal Tax Service dated 24 April 2012).
- The qualification criteria for a 'large taxpayer' at the federal level are even higher.

The APA application fee is USD 50,000. If taxpayer had complied with the conditions of APA (including confirmation during tax audit) the Russian TA has no right to make the decision about the tax crime, fines and penalties or the reduction of the amount of loss with respect to those controlled transactions, and prices for which (methods) were agreed in the APA.

Ex post measures to prevent double taxation

As of September 2017, Russia is a party to 83 Tax Treaties. Most of them are concluded regarding OECD provisions, so the 'Associated Enterprises' article is included in such treaties. This article provides for correlative adjustments in the majority of the treaties (although primarily those concluded recently). In the older treaties, this article provided for a one-way adjustment that increases the profit of a treaty resident due to the use of non-market prices.

In May 2016, the FTS signed a multilateral agreement on automatic exchange of financial information (Multilateral Competent Authority Agreement) within the framework of the General standard for automated exchange of financial information (CRS).

Intercompany Financing

Since 1 January 2017, new legislation regarding application of the thin capitalisation rules to loans from foreign companies, which are not direct or indirect participants of the borrower, came into force (art. 269 of the RTC). The legislation also introduced a number of exemptions:

- For loans from related Russian companies, if such companies do not further pay such interest abroad;
- For loans from unrelated banks guaranteed by group companies in the absence of payments under such guarantees.

Main provisions:

- Loans provided exclusively within Russia will not be controlled (provided certain requirements are met);
- All listed liabilities of a taxpayer should be considered in aggregate (so the split of loans will not allow for avoiding the rules);
- A debt arising upon the issue of Eurobonds is not subject to the rules.

Safe harbour provisions/exemptions for SMEs

The Russian TP legislation extends the list of comparability factors to be considered during the TP analysis. In particular, the company's functional and risk profile and business strategy will be introduced as comparability factors. However, there are no special safe harbours in the new rules (the old law, which was effective before 1 January 2012, allowed 20 percent deviations from the market price).

For loan controlled transactions, the following ranges of interest are established:

1. for a debt obligation issued in Rubles and incurred as a result of a controlled transaction:
 - from 0 to 180 percent (from January 1, 2015 to December 31, 2015), or from 75 to 125 percent (from January 1, 2016 onwards) of the key rate of the Central Bank of the Russian Federation; or
 - from 75 percent of the discount rate of the Central Bank of the Russian Federation to 180 percent of the key rate of the Central Bank of the Russian Federation (from January 1, 2015 to December 31, 2015), or from 75 up to 125 percent (from January 1, 2016 onwards) of the key rate of the Central Bank of the Russian Federation.
2. for loans in foreign currencies, the ranges of interest are established due to the interbank rates.

Exemptions for SMEs: the financial thresholds regarding annual revenue for companies that apply simplified taxation regimes are established. In General, the threshold is 60 million Rubles (USD 1 million.).

TP and PEs (AOA)

Russian tax law has recently been amended to include a special provision on the taxable income of PEs. When determining the taxable income of a PE in Russia, the entity's functions, assets, and economic and commercial risks should be taken into account. This provision does not contain any guidance on specific TP methods taxpayers should follow. In addition, court practice regarding this approach has not been developed.

The Russian TP legislation also determines conditions for recognition of a foreign company as a Russian tax resident. Thus, if a foreign company realises goods or services on the territory of the Russian Federation through the PE, which is defined as a branch, representation, bureau, office, agency, or any other separate division through which organisation carries on business activities on the territory of the Russian Federation, and obtains income, it recognises as a Russian tax resident.

In accordance with the letter # 03-01-18/9-183 of the Russian Ministry of Finance of 03.12.2012, in cases when one related party of the controlled transaction is registered abroad, but acting through a PE, the situation must be controlled as if beneficiaries were located on the territory of different countries. So, transactions with PE should be controlled under TP rules.

Other topics

The Russian Ministry of Finance and Federal Tax Service issued a number of unofficial clarifications on the application of TP rules (e.g. clarifications on calculation of the financial threshold, interdependence of parties for TP purposes, and other technical aspects of application of TP rules).

As of September 217, the Russian State Duma is considering a bill that requires the provision of three tier TPD. It is expected that such law will come in force starting in 2018. According to this law, organisations that are members of MNEs should provide three tier reporting to the Russian TA (including CbCR, global (Master File) and national documentation (Local File)). The Russian TA will automatically exchange the CbCR of such MNEs to prevent abuses of the RTC. It should be noted that the Russian TA can already exchange information on TP matters under the current DTTs and in accordance with the OECD's Convention on Mutual Administrative Assistance in Tax Matters.

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Serbia



Statutory rules/laws

- Articles 59, 60, 61, and 61a of Corporate Income Tax Law (Official Gazette RS No. 25/2001, 80/2002, 80/2002 – other law, 43/2003, 84/2004, 18/2010, 101/2011, 119/2012, 47/2013, 108/2013, 68/2014 – other law, 142/2014, 91/2015 – authentic interpretation and 112/2015)
- The Protocol on transfer prices and methods applied in accordance with the ‘arm’s length’ principle when assessing the prices of transactions between related parties (Official Gazette RS No. 61/2013, 8/2014)
- Rulebook on Informative Tax Return (Official Gazette RS No. 117/2012, 118/2012 – correction, 16/2013)
- Rulebook with respect to arm’s length interest rates for loans and credit transactions

Definition of related party

The term “related party” is defined in article 59 of Corporate Income Tax Law. According to this provision:

- an entity is deemed a related party if it has the possibility of control or considerable influence on the business decisions made, while ownership of at least 25 percent of the shares in the capital is considered as the possibility of control and possessing at least 25 percent of the voting rights is considered as having an influence on business decisions;
- members of the immediate family of shareholders who own at least 25 percent of shares or hold at least 25 percent of voting rights are also deemed as related parties.

These examinations are applied to both direct and indirect ownership. Furthermore, companies are deemed to be related if the same persons directly or indirectly participate in the management, ownership, or control of both companies in the manner described above.

Regardless of the percentage of direct or indirect ownership or voting rights in a Serbian enterprise, any company which is residential at a jurisdiction with a preferential tax system, is considered to be a related party. A jurisdiction with a preferential tax system exists if the relevant regulations allow for a significant reduction in income and dividend taxation when compared to Serbian regulations. A territory also qualifies as a jurisdiction with a preferential tax system if its regulations do not allow or impede obtaining information on ownership or other data relevant for resolving taxation issues.

Treatment of the OECD Guidelines

Serbian authorities adopted the published Protocol on transfer prices and methods applied in accordance with the ‘arm’s length’ principle when assessing the prices of transactions between related parties. When TPD is prepared in accordance with the Protocol, its content should follow Chapter V of OECD Guidelines.

Accepted TP methods and priority

The Serbian TA adopts the TP methods prescribed by the OECD Guidelines. There is no priority among the acceptable methods, and the new TP regulations prescribe the use of the most appropriate method. This implies that taxpayers are allowed to choose methods to be used in determination of arm's length prices and preparation of TP study.

The method is chosen on the level of each type of transaction. Combining two or more methods is also allowed. However, the method that has been chosen must be practically applicable and should eventually result in a reasonable estimate of effects in accordance with the arm's length principle.

Interest rates can also be assessed using an interest rate prescribed as arm's length by the Ministry of Finance of the Republic of Serbia.

Documentation requirements

A taxpayer has the obligation to prepare and submit documentation which presents related party transactions at both transfer prices and arm's length prices along with their annual tax return (i.e. within 180 days from the last date of a tax period).

A taxpayer is required to submit the following local TPD file to the Serbian TA:

- **full-scope TPD** – includes analysis of the group of related entities, business activity analysis, functional analysis, selection of TP method, benchmarking analysis, and conclusion of the TP analysis; or
- **simplified TPD** – includes only basic data about intercompany transactions of a taxpayer, without detailed analysis which supports arm's length character of the intercompany transactions.

The simplified TP file shall be submitted if the following conditions are met:

- specific related party transaction is regarded to be a one-off transaction and does not exceed RSD 8 million in a fiscal year; and/or
- **total** value of all transactions with a specific related party during a fiscal year does not exceed RSD 8 million.

A proper disclosure of the CIT return requires the separate disclosure of income and expenses generated from related party transactions during the year.

The following mandatory elements of full-scope TPD are prescribed by the Protocol on transfer prices and methods applied in accordance with the 'arm's length' principle when assessing the prices of transactions between related parties:

- analysis of the group of related entities whose member is the taxpayer;
- business activity analysis;
- functional analysis;
- selection of method used in determination of TP;
- conclusion – is it required to amend taxable base for related party transactions; and
- appendices – review of data used by the taxpayer in determination of arm's length prices.

The taxpayer is not obliged to submit separate documentation pertinent to particular transactions and relations between parties within a group. However, the Serbian TA may also require such additional documentation. In addition, the Protocol permits the Serbian TA to require the additional documentation from the taxpayer, if it determines that the taxpayer's documentation is insufficient for the assessment of whether the transfer prices are in line with the arm's length prices. In the latter case, the Serbian TA is obliged to take into the consideration expenses imposed to the taxpayer with the request for the additional documentation, as well as on the overall possibility of the taxpayer to provide the additional documentation. When additional documentation is requested, the Serbian TA allows to the taxpayer an appropriate deadline.

The TP study should be either prepared in the Serbian language or translated to Serbian.

Tax audit procedure

The Serbian TA usually examines the adequateness of intercompany TP only during the regular tax field audits. Tax audits typically cover periods from three to five consecutive fiscal years. In case of a tax audit, the taxpayer is generally obliged to cooperate with the tax auditors.

When the Serbian TA requests a taxpayer's TPD, the documentation should be available upon request. However, an additional 30 to 90 day deadline can be provided for submitting and amending the documentation.

Currently, outcomes from audits are revealing that the Serbian TAs prefer the CUP Method, but this method is applied in a very simplified way.

Statute of the limitation period for the tax audit is five years, starting from the first day of a year following a year in which the tax liability became due (e.g. statute of limitation for tax liability due in 2016 is 31 December 2021). A ten years absolute statute of limitation period is also applicable under certain circumstances.

Income adjustment, surcharges, and penalties

It is permitted to make the income adjustment to the most unfavorable point of the arm's length range. When adjustments are assessed by the Serbian TA, they must be applied and then the taxpayer has an option to appeal to the second instance degree procedure with the Serbian TAs, or finally to the Administrative Court.

If an adjustment is sustained, penalties may range from RSD 100,000 to RSD 2,000,000 (approximately from €900 to €17,000 for non-disclosing of transfer prices at arm's length in the tax balance. In addition, there is a potential penalty depending on the additional tax liability assessed by the Serbian TA. This penalty varies from 1 percent to 25 percent of the assessed additional tax liability but not less than RSD 100,000.

TP penalties are rarely enforced. Preparing TPD should mitigate the risk of penalties. Other defense strategies may include negotiation and reasonable cause, but such strategies are less likely to have the desired positive effects.

Advance pricing agreements

No APAs or advance rulings of any kind or similar are available in Serbia at the moment. The Serbian TA does not publish APA data either in the form of an annual report or through the disclosure of data in public forums.

Ex post measures to prevent double taxation

The extent of the Tax Treaty network is minimal in Serbia at the moment. There is no experience in Serbia that the CA is effective in obtaining double tax relief.

Intercompany financing

Serbia's Minister of Finance adopted a "Rulebook" on 18 March 2017 with respect to arm's length interest rates. The Rulebook provides the prescribed interest rates **applicable to related-party financing arrangements** and is applicable for taxpayers with related-party financing during 2017. The Rulebook was published in the Official Gazette RS No. 21/2017 on 18 March 2017.

Safe harbour provisions/exemptions for SMEs

There are no "safe harbour" provisions/exemptions for SMEs in Serbia.

TP and PEs (AOA)

There has not been any legislation in Serbia in response to the AOA.

Contact information

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Singapore



Statutory rules/laws

- Section 34D of the Singapore Income Tax Act (“SITA”) stipulates the use of the arm’s length principle for related party transactions.
- The concept or use of the principle is also implied or referred to in various provisions of the SITA, including Sections 32 and 53.

Definition of related party

Related party is defined under Section 13(16) of the SITA to mean any other person:

- Who, directly or indirectly, controls that person;
- Who is, directly or indirectly, controlled by that person; or
- Where both persons are, directly or indirectly, controlled by a common person.

Treatment of the OECD Guidelines

The Inland Revenue Authority of Singapore (“IRAS”) generally takes guidance from the OECD Guidelines.

Accepted TP methods and priority

IRAS adopts the TP methods prescribed by the OECD Guidelines. As the CUP Method is the most direct way to determine arm’s length price, IRAS generally prefers this method to be adopted by taxpayers.

Documentation requirements

- Singapore taxpayers should prepare and keep contemporaneous TP documentation.

TP documentation refers to the records kept by taxpayers to demonstrate that their related party transactions were conducted at arm’s length.

IRAS does not require taxpayers to submit the TP documentation when they file their tax returns. Taxpayers should retain their TP documentation and only submit it to IRAS within 30 days upon request.

For ease of compliance, IRAS will also accept as contemporaneous TP documentation any documentation prepared at any time no later than the time of completing and filing the tax return for the financial year in which the transactions took place.
- English is the general and accepted language used in practice. IRAS may request for translation of any TP documentation not written in English.

- c. There is no direct reference to the requirements in OECD Guidelines. However, there is substantial overlap between the Singapore and OECD documentation requirements:-
- Description of the organisational and management structure of the Singapore tax payer;
 - Description of the Singapore taxpayer's business, products and services, industry dynamics, markets, regulatory and economic conditions;
 - Description of the choice of the TP method and substantiate the method is the best (most appropriate);
 - Description of comparables and the comparative analysis of the related-party transactions/tested party and the comparables;
 - Details of any adjustments made to achieve comparability.

Singapore taxpayers are to provide documentation of their group and the specific members of the group with which they transact as follows:-

- Group Level: An overview of the group's global businesses that is relevant to the business operations in Singapore (i.e., organisation structure and overall TP policies).
- Entity Level: Details of the Singapore taxpayer's business and the transactions with its related parties; including functional analysis and TP analysis.

Tax audit procedure

IRAS reviews and audits the TP methods and documentation of selected taxpayers through the "Transfer Pricing Consultation ("TPC") programme.

IRAS selects taxpayers for TPC based on risk indicators. Examples of circumstances in which TP risks may be considered high are:

- a. Transactions with cross-border related parties that are of large value relative to the other transactions of the taxpayer;
- b. Transactions with related parties subject to a more favourable tax treatment.
- c. Operating results that are not in line with businesses in comparable circumstances.

If necessary, IRAS may send questionnaires or information requests to obtain more data or information from taxpayers for risk assessment purposes.

The TPC starts with a first meeting with the taxpayer's representatives at the taxpayer's premises. IRAS will interview key personnel and review the TP documentation.

Thereafter, IRAS will request for more information or documents concerning particular issues and may arrange for subsequent meetings with the taxpayer.

IRAS will review all information gathered and assess the adequacy of the taxpayer's TP documentation and identify TP issues for discussion with the taxpayer.

IRAS may propose a tax adjustment pursuant to Section 34D of the SITA if the taxpayer's profit is understated due to non-arm's length related party transactions.

The taxpayer can respond to IRAS's proposal and attempt to discuss and resolve the issues before IRAS makes any tax adjustment.

At the end of the TPC, IRAS will send a letter to the taxpayer commenting on the appropriateness of taxpayer's transfer pricing method and adequacy of the TP documentation. IRAS may make recommendations on improvements.

Income adjustment, surcharges, and penalties

Presently, there is no legislation that deals with the type of adjustments the comptroller may undertake to enforce the arm's length principle.

There is also no current legislation that imposes any surcharge on the TP adjustments nor deals with penalties for the failure to prepare, maintain, and submit contemporaneous TP documentation.

Advance pricing agreements

The Singapore taxpayer may choose to avoid TP disputes by applying for an APA for its related party transactions for future years. The taxpayer may apply for unilateral, bilateral, and multilateral APAs.

IRAS will generally accept an APA request to cover three to five future financial years.

Ex post measures to prevent double taxation

MAP is a dispute resolution facility provided under the MAP Article in Singapore's Tax Treaties.

MAP is available to:

- a. Taxpayers that are Singapore tax residents; and
- b. Taxpayers who are not Singapore tax residents but have a branch in Singapore.

MAP should be initiated within the time limit specified (e.g. 3 years) in the MAP Article of the relevant Tax Treaty. Failure to do so may result in the Singaporean or foreign CA rejecting the MAP request.

Intercompany financing

Related party loans and arm's length interest

The "arm's length interest rate" is the interest rate which would have been charged between independent parties under similar circumstances at the time the indebtedness arose.

In the case of related domestic loan given by a taxpayer which is not in the business of borrowing and lending, IRAS will apply interest charged on such loan.

In all other cases, taxpayers should follow the arm's length method to determine the interest charges.

The "arm's length interest rate" is the interest rate which would have been charged between independent parties under similar circumstances at the time the indebtedness arose.

In the case of related domestic loan given by a taxpayer which is not in the business of borrowing and lending, IRAS will apply interest restriction in place of the arm's length approach. Taxpayer's claim for any interest expense is limited to the actual interest charged on such loan.

In all other cases, taxpayers should follow the arm's length method to determine the interest charges.

Determination of arm's length interest

IRAS guidelines mention that the CUP Method is the preferred method for determining the arm's length pricing for related party loans as it is the most suitable method for loan transactions.

If an appropriate CUP is not available, tax payers can first identify a suitable base reference rate (SIBOR or LIBOR) or prime rates offered by banks. Then, the taxpayer can determine the margin by reference to the estimated credit rating of the borrower.

The arm's length interest rate is the sum of the base reference rate and the margin.

To facilitate compliance with the arm's length principle, IRAS has offered an indicative margin which taxpayers can apply on their related party loans obtained or provided from 1 January 2017. The indicative margin is not mandatory.

The indicative margin is published on IRAS website and will be updated at the beginning of each year.

Deductibility of interest

Subject to certain restrictions, interest expenses are generally deductible for tax purposes.

Treatment of cancellation of loan

Any waiver of a loan, which is treated as "income" to the borrower, is capital in nature and, therefore, non-taxable.

Safe harbour provisions/exemptions for SMEs

IRAS has administrative rules that exempt taxpayers from preparing TP documentation under certain situations:-

- a. Where the taxpayer transacts with a related party in Singapore and such local transactions (excluding related party loans) are taxable to both parties at the same Singapore tax rate.
- b. Where related domestic loan is provided by taxpayer to a related party in Singapore and the lender is not in the business of borrowing and lending.
- c. Where the taxpayer applies the 5 percent cost mark-up for routine services in respect of related party transactions in accordance with IRAS administrative practice.
- d. Where the taxpayer applies the indicative margin for related part loans in accordance with IRAS administrative practice.
- e. Where the related-party transactions are covered by an APA.

For all other related-party transactions, excluding the transactions in (a) to (e) above, TP documentation is not required if the value or amount of the related-party transactions does not exceed the following thresholds per Financial Year (FY):

- Purchase of goods from all related parties S\$ 15 million
- Sales of goods to all related parties S\$ 15 million
- Loans owed to all related parties S\$ 15 million
- Loans owed by all related parties S\$ 15 million

For all other categories of related-party transactions below, the threshold is S\$ 1 million per category:

- Service income
- Royalty income
- Rental income
- Guarantee income
- Service expense
- Royalty expense
- Rental expense
- Guarantee expense

For purposes of determining the threshold, aggregation should be done for each category of related party transactions.

TP and PEs (AOA)

IRAS guidelines clarify that where the activities performed by a taxpayer for its foreign related party creates a PE for the latter in Singapore, no further attribution of profits to the PE and thus no additional Singapore tax liability will arise if following conditions are met:

- Taxpayer receives an arm's length remuneration from its foreign related party that;
- The remuneration paid to the taxpayer is supported by sufficient TP documentation; and
- The foreign related party does not perform any functions, use any assets or assume any risks in Singapore.

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Slovakia



Statutory rules/laws

a. Laws

No. 595/2003. Income Tax Act (Sections 2, 17 and 18),

The most recent guidance on the required contents of the TPD is Guidance No. MF/014283/2016-724 (applicable for fiscal years 2015 and 2016) of the Ministry of Finance of the Slovak Republic,

There are previous guidances pertaining to earlier periods (MF/8288/2009-72: valid for fiscal years 2009 – 2013, MF/8120/214-721: valid for fiscal year 2014)

b. Other

Articles in the Financial Reporters published by the Ministry of Finance of the Slovak Republic – they are not legally binding, but generally accepted and applied.

Definition of related party

The term “related party” is defined in Section 2 of the Income Tax Act No. 595/2003.

Related party shall mean a close party (defined in the Civil Code of Slovakia) or another party, which is economically, personally, or otherwise interrelated with the first party.

“Economic or personal interrelation” shall mean a situation, in which one party participates in the ownership, control, or administration of another party, or shall mean a relation between parties, which are under the control or administration of the same party.

- The participation in ownership/control means that one party directly or indirectly participates in another party's or (parties') capital or voting rights, and it has a holding of more than 25 percent of the capital or voting rights.
- The participation in administration means the relationship of members of statutory bodies or supervisory bodies of a business company, or co-operative, towards such a business company, or co-operative.
- “Other interrelation” shall mean a relationship established in particular for the purpose of reduction of the tax base or increase of tax loss.

Treatment of the OECD Guidelines

The abovementioned law, guidances, articles and tax legislation are generally based on the OECD Guidelines and the Code of Conduct made by the EU JTP Forum.

Accepted TP methods and priority

Slovakia adopts the TP methods prescribed by the OECD Guidelines. Additionally, there is no priority among the methods, the most appropriate one shall be chosen by the taxpayer.

Documentation requirements

Companies have the legal obligation to prepare TP documentation. There are no formal deadlines, and the document should be presented as evidence during the audit. However, in case of a challenge by the Slovak TA, documentation shall be generally submitted within 15 days after the request of the Slovak TA.

The preferred language is Slovakian. However, in case of a preliminary request, other languages (English, German, or French) may be accepted.

There is no exemption from the preparation of TP documentation report, but 3 types of documents may be prepared:

- The “**Simplified Documentation**” (for natural persons and micro enterprises):

This document only consists of general information of the group and the description of related transactions. It is worth mentioning that the document, albeit sufficient from legal point of view, could be unsatisfactory for supporting TP, which means at least a basic documentation may be required for a successful tax audit.

- The “**Full-Scope Documentation**” (mandatory for taxpayers preparing financial statements under IFRS, taxpayers performing transactions with related parties resident in non-treaty countries, taxpayers requesting advance pricing agreements, taxpayers requesting corresponding adjustments, taxpayers utilising tax loss in the amount exceeding €300K or exceeding aggregate amount of €400K in two consecutive taxation periods and taxpayers utilising tax reliefs);

This document consists of a Master File (detailed information regarding the entire group) and a Local File (detailed information regarding the Slovakian entity and its related transactions performed); or,

- The “**Basic Documentation**” (for all taxpayers not falling into the abovementioned categories):

This document also consists of a Master File and a Local File. However, the required amount of data is less and one of the most significant differences is that no benchmark analysis is needed. It should contain general information of the group and the Slovakian entity, the description of related transactions, a functional analysis, and the applied TP method.

Tax audit procedure

In case of a tax audit, the recent likelihood for reviewing the transfer prices is significant (medium to high) for those entities which are obliged to prepare full-scope document and even for those who are required to maintain only the basic report. In 2013, the Slovak TA has established a separate department, including professionals strongly specialised in TP.

Income adjustment, surcharges, and penalties

If the taxpayer fails to deliver the document to the Slovak TA, the penalty is €3,000, which can be levied multiple times.

In case of breaching the arm's length principle, a penalty of three times the European Central Bank ("ECB") prime interest rate or 10 percent (the higher of them) is applicable based on the amount of unpaid taxes.

The late payment interest rate is either four times the ECB basic rate or 15 percent (the higher one is applicable).

Since 2017, taxpayers who deliberately realised a lower profit due to the applied transfer prices with their international related parties may expect a doubled penalty interest rate (20 percent).

Advance pricing agreements

Taxpayers may file an advance pricing agreement request and the Slovak TA may approve the request for a transaction performed in a specific period or will be performed in the future.

The Slovak TA approves only the applied method and not the applicable mark-ups or margins.

Since 2017, the fee for a unilateral APA is €10,000, while for a bilateral/multilateral APA is €30,000.

In case of an approval, the maximum period for the advance pricing agreement is 5 years.

Ex post measures to prevent double taxation

The Slovak Republic has signed onto the MLI on 7th June 2017, and the country has 65 Tax Treaties in effect, according to the data published by the Ministry of Finance of the Slovak Republic.

The MAP request has to be filed to the Ministry of Finance within the period defined in the relevant treaty.

Local administrative appeal procedures and roll-back bilateral APAs are also available options for taxpayers.

Intercompany financing

There are no specific rules regarding intercompany financing. However, it is generally expected from the taxpayer that the adequate arm's length consideration for the financing services shall be determined according to the financial market and based on similar financing services rendered under similar circumstances (credit rating, duration, sum, etc.) as between unrelated comparable parties.

Safe harbour provisions/exemptions for SMEs

Safe harbour rules do not exist in the Slovak jurisdiction, and there are no exemptions neither for SMEs nor for another segment of taxpayers (e.g. domestic transactions).

TP and PEs (AOA)

Slovakia does not apply AOA, and there is also no information whether an implementation in domestic law is planned in the future.

The tax legislation generally allows the “indirect method” for allocating assets, free capital, and profits only if the direct attribution of cost or revenue is not possible.

Other topics

Documentation obligation for transactions entered into by domestic related parties and some specific documentation rules for pharmaceutical companies have been recently introduced.

The Slovak TA does not require the use of local comparables in a benchmarking study or comparative analysis, it uses the Amadeus database, and maintains its own internal comparables. The Slovak TA considers the interquartile range as arm’s length in case of applying the TNMM.

The document should not be disclosed to the tax return (the filing deadline of which is 3 month following the last day of the fiscal year). However, the data of transactions undertaken with the related parties should be indicated in the notes to the financial statement.

The statute of limitations is 5 years from the year in which the tax return is filed. If a Tax Treaty is applied, the limitation is 10 years.

A legislation was passed in December 2016 to make CbCR and CbC exchange measures part of Slovakian law. This is effective as of 1st March 2017 by applying OECD’s relating minimum standards. Companies that are part of a multinational group with a total consolidated turnover reaching €750 million have to notify the Slovak TA about the reporting entity of the group. The deadline for notification for each fiscal year is the filing date of the CIT return (which shall be done within 3 calendar months after the closing date of the given year). The notification had to be made first for FY2016.

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Slovenia



Statutory rules/laws

a. Laws

- CIT Act (Articles 16 – 19, 32, 72)
- Regulation on TP
- Regulation on the acknowledged interest rates
- Tax Procedure Act (Articles 382, 397 and 398)

b. Other

Explanations of the Slovene TA are not legally binding, but generally accepted and applied.

Definition of related party

The term of related party (“associated enterprise”) is defined in article 16 of the Corporate Income Tax Act, according to the following:

- the taxpayer directly or indirectly holds at least 25 percent of the value or number of shares or equity holdings, shares in managing or control and/or voting rights of a foreign person, or controls the foreign person on the basis of a contract, or the transaction conditions differ from the conditions that have been or would have been agreed between non-associated enterprises under equal or comparable circumstances; or
- the foreign person directly or indirectly holds at least 25 percent of the value or number of shares or equity holdings, shares in managing or control and/or voting rights of the taxpayer, or controls the taxpayer on the basis of a contract, or the transaction conditions differ from the conditions that have been or would have been agreed between non-associated enterprises under equal or comparable circumstances; or
- the same person at the same time directly or indirectly holds at least 25 percent of the value or number of shares or equity holdings, shares in managing or control and/or voting rights of the taxpayer and foreign person or of two taxpayers, or controls these persons on the basis of a contract, or the transaction conditions differ from the conditions that have been or would have been agreed between non-associated enterprises under equal or comparable circumstances; or
- the same individuals or their family members directly or indirectly hold at least 25 percent of the value or number of shares or equity holdings, shares in managing or control and/or voting rights of the taxpayer and foreign person or of two residents or control them on the basis of a contract, or the transaction conditions differ from the conditions that have been or would have been agreed between non-associated enterprises under equal or comparable circumstances. As the family member, following persons are considered: spouse or person with whom the individual lives in a long term relationship that equals marriage, children, adopted children, step-children or children of the person with whom the individual lives in a long term relationship, parents or adoptive parents of an individual.

Treatment of the OECD Guidelines

The abovementioned laws, regulations, explanations, and tax legislation are generally based on the OECD Guidelines and the Code of Conduct made by the EU JTP Forum.

Accepted TP methods and priority

Slovenia adopts the TP methods prescribed by the OECD Guidelines. Additionally, the CUP Method is preferred over any method, and the traditional transaction-based methods are preferred over the profit-based methods.

Documentation requirements

Companies have the legal obligation to prepare TPD. The deadline is identical to the corporate income tax return filing date, which is maximum 3 months after the end of the fiscal year. The document shall not be filed with the tax return.

The document should be prepared by BEPS Action 13 Master File/Local File concepts.

The Master File should be made by the leader of the group and the most relevant group – level information should be contained:

- organisational structure of the group;
- economic description of the group (business and environment, strategy, financial position, etc.);
- related transactions performed within the group;
- the applied method for determining the intra-group prices.

The Local File should be made by the local related party and the most relevant information should be contained:

- the presentation of the company, its position within the group, and its business strategies;
- the functional analysis of the related parties performed;
- the description of the related transactions (type, volume, term of contracts, etc.);
- the description of the method applied for establishing the arm's length price and the unrelated comparable data used.

The language of the local file is exclusively Slovene. However, the Master File may be prepared in any foreign language, but the Slovene TA may request for a translation.

Tax audit procedure

In case of a tax audit, the likelihood for reviewing and even challenging the transfer prices is significant (medium to high). The “hot” topics are intra-group services, financial transactions, and intangible goods.

During a tax audit, TPD shall be immediately presented upon request. However, the Slovene TA may allow an additional deadline ranging from 30 to 90 days depending on the complexity.

Tax audits generally cover 3 to 5 consecutive tax years.

Income adjustment, surcharges, and penalties

Penalties are applicable both for breaching the TPD obligation and for the inappropriate (lower than arm's length) determination of the corporate tax base. The level/amount of penalties depends on the size of the company, and the responsible person of the company can also be penalised.

Penalties vary in the following way:

- Breaching of TPD obligation: From €1,200 to €30,000 for companies (depending on their size), and from €600 to €4,000 for the responsible person.
- Tax shortfall: 30 percent or 45 percent of the shortfall (with a cap of €150k or €300k) for companies (depending on their size), and from €700 to €5,000 for the responsible person. For the unpaid taxes, a late payment interest is also applicable, calculated on a daily basis.

Company size categories are: (i) micro/small, (ii) medium/large.

Advance pricing agreements

Since 2017, taxpayers may file an APA request.

The administrative fee is €15,000.

In case of an approval, the maximum period for the APA is 5 years.

Ex post measures to prevent double taxation

Slovenia has signed onto the MLI on 7th June 2017 and the country has 58 DTT-s in effect according to the data published by the Ministry of Finance.

The MAP request has to be filed to the Ministry of Finance within the period defined in the relevant treaty.

Local administrative appeal procedures are available and APA-s can be applied for previous tax years in case of such agreement between the taxpayer and the Slovene TA.

Intercompany financing

There are specific rules regarding the intercompany financing.

During the calculation of the revenue/expenses, the taxpayer has to take into consideration the interest rates published by the Minister of Finance (acknowledged interest rates) and they should be used if they are higher/lower than the actually applied related interest rate(s). However, if the taxpayer manages to prove that in comparable circumstances equal or similar financial transactions would be undertaken between uncontrolled parties at interest rates which are lower/higher than the acknowledged interest rates, then the utilisation of the acknowledged interest rates may be ignored.

Safe harbour provisions/exemptions for SMEs

The acknowledged interest rates create a safe harbour for interest rates on intercompany financial transactions in the Slovene jurisdiction, no other safe harbours are currently applied.

There are no exemptions neither for SMEs nor for another segment of taxpayers.

TP and PEs (AOA)

The Republic of Slovenia adopts the AOA. However, it is not defined in a national law, but may be derived from the OECD commentary interpreted by the Slovene TA.

The tax legislation allows both the “direct” and “indirect method” for allocating assets, free capital, and profits as long as it is reasonable.

Other topics

The Slovene TA prefers the use of local comparables in a benchmarking study or comparative analysis (if they are available). The Slovene TA considers the interquartile range as arm’s length in a TNMM analysis, and it typically accepts averaging results of the comparables covering multiple years. Secret comparables are used by the Slovene TA, but only with an internal purpose; no adjustments can be based on them.

The document should not be disclosed to the tax return. However, the transactions undertaken with the related parties should be indicated in the notes to the financial statements.

The statute of limitations is 5 years from the year in which the tax return is filed. In case of an assessment, the 5 years period can be reset, but after 10 years the statute of limitations expires anyway.

The Republic of Slovenia has implemented CbCR as of January 1, 2017 by applying OECD’s relating minimum standards. Companies that are part of a multinational group with a total consolidated turnover reaching €750 million have to notify the Slovene TA about the reporting entity of the group. The notification has to be attached to the CIT return, first time for FY2017. The deadline for filing the CIT return is 3 calendar months after the closing date of the given year.

Contact information

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South Africa



Statutory rules/laws

- Section 31 of the Income Tax Act.
- Notice No.1334 concerning additional TPD requirements, under Section 29 of the Tax Administration Act (“TAA”).

Definition of related party

South African legislation defines “connected persons” in Section 1 of the Income Tax Act and also contains specific anti-avoidance section, which expands the connected person rules.

The meaning of “connected” person is distinguished in relation to different types of persons, being a natural person, a trust, and a company as follows:

- A natural person means any relative or any trust (other than a portfolio of a collective investment scheme in securities or in property);
- A trust (other than a portfolio of a collective investment scheme in securities or in property) means any beneficiary of such trust, or any connected person in relation to such beneficiary;
- A company means any other company that is part of the same group of companies, any person other than a company as defined in section 1 of the Companies Act, 2008 who individually or jointly with any connected person in relation to himself, holds, directly or indirectly, at least 20 percent of the equity shares of voting rights in the company, or any other company if such company is managed or controlled by any person that is a connected person in relation to such company or any person that is a connected person in relation to the first mentioned person.

Treatment of the OECD Guidelines

South Africa is not a member country of the OECD, but is subscribed to the OECD approach and generally adopts the OECD Guidelines. South Africa bases profit allocation on the old version of article 7 of the Model Treaty.

Accepted TP methods and priority

Although not a member state, the TP methods accepted by South Africa’s TA are similar to the TP methods specified by the OECD Guidelines. South Africa has no specific rules, i.e. neither the “direct method” nor the “indirect method” are referred as long as the profit allocation is done on an arm’s length basis. There is no priority of methods. However, the most appropriate method should be selected and the reason for the choice should be documented.

Documentation requirements

For years of assessment commencing on or after 1 October 2016, it is obligatory for taxpayers with qualifying transactions to prepare TP policies and documentation. Where a transaction between a resident and non-resident (or a non-resident and a PE of another non resident in South Africa, or a resident and a PE of a resident outside South Africa) is not carried out on an arm's length basis, the amount of the transaction may be adjusted.

A further requirement is that the CbCR as well as the TPD (Master File and Local File) must be physically submitted to South African Revenue Service ("SARS") by 31 December 2017.

Legislation requires taxpayers to file returns on the basis that any transactions falling within the ambit of the TP rules are conducted at arm's length. Therefore, to the extent that TP adjustments are required, the taxpayer must do such adjustments itself in preparing its tax return. The annual tax return requires additional disclosure on all transactions with both connected and independent parties both domestic and foreign.

The taxpayer is also required to answer a number of questions in relation to, inter alia, documentation and year end TP adjustments. In the context of TPD, the taxpayer is asked whether the company has TPD that supports the pricing policy applied to each transaction between the company and the foreign connected person during the year of assessment as being at arm's length.

Tax audit procedure

TP has been flagged as one of the key focus areas, and SARS continues with major audits that could lead to substantial adjustments. TP record retention rules make TPD compulsory for all taxpayers who have cross-border transactions with foreign related parties.

Group documentation retained centrally outside South Africa will not be sufficient to satisfy the new record keeping requirements. Although these records provide a valuable starting point, they would need to be adapted into documentation which is specific to the South African entity or entities and additional records must be kept. This can include detailed information about foreign group companies. Taxpayers must therefore ensure that they either have this information or are able to access it if required.

Income adjustment, surcharges, and penalties

Severe penalties of up to 200 percent on the tax relating to the understatement of income may be imposed in terms of the provisions of the TAA. Interest at the current rate of 10.25 percent will also be levied on the taxes resulting in the understatement.

Advance pricing agreements

Cognisance should be taken of the following:

- Business transformation – planning TP on a global scale
- Compliance and document management using:
 - Global core documentation ("GCD") is a methodology that leverages off the development of base documentation to provide an efficient global solution.

- Providing a cost effective document solution to meet TP compliance needs of SMEs.
- Audit defence strategies assist clients to understand the risks and have a sophisticated and tailored audit defence strategy.
- TP project platform, a web based solution for organising and storing of TPD and information,
- Knowledge sharing, a global electronic network that provides members with up-to-date information about:
 - alerts on significant breaking news in TP;
 - updates on developments locally and internationally;
 - insight into moves by SARS; and
 - access to a national and international network of TP experts.

Ex post measures to prevent double taxation

South Africa is a signatory country of the MLI and modifications to existing Tax Treaties would most probably enter into effect in early 2018. South Africa has 79 comprehensive Tax Treaties with countries around the globe. A dispute resolution process, including objections and appeals, are also available. South Africa has an advanced tax ruling regime, but has specifically excluded TP from this.

Intercompany financing

Inbound financial assistance falls into the general TP provisions, which require the amount of debt and associated interest rate to be substantiated as being arm's length in the same way as all other transactions. Clarity is still needed on the tax treatment of thin capitalisation. These rules potentially apply when a South African company receives inbound loans from a foreign related party. The rules limit the extent of the interest liability which the local company can incur. A company, which is considered to have borrowed too heavily, is described as thinly capitalised. The thin capitalisation rules were complicated by the introduction of debt restriction rules effective from 1 January 2015.

SARS considers that a greater thin capitalisation risk exists if the debt to EBITDA ratio of a South African taxpayer exceeds 3:1. This ratio is not a safe harbour and may vary in different industries. SARS further considers it a high risk if interest on a foreign-denominated debt is more than 2 percentage points above the base rate of the foreign country.

South Africa also introduced a withholding tax on interest with effect from 1 January 2015. Based on the current wording, it appears that, where there is a foreign recipient of interest (paid from South Africa) who is subject to withholding tax (even at a reduced rate by virtue of a tax treaty), the excessive debt rules will not apply to the South African borrower.

The excess interest adjustment will give rise to a deemed dividend by the South African entity to the foreign related entity. This deemed dividend is subject to dividends withholding tax at the rate of 20 percent. The rate may be reduced by the provisions of a relevant Tax Treaty.

Safe harbour provisions/exemptions for SMEs

Full compliance is required where the total value of such transactions exceeds R100 million and applies to each type of transaction to the total value of R5 million per year. However, even taxpayers which fall below these thresholds are required to keep some records, in order to demonstrate to SARS that the transactions are arm's length.

TP and PEs (AOA)

South Africa does not apply the AOA.

Contact information

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South Korea



Statutory rules/laws

- ADJUSTMENT ACT OF INTERNATIONAL TAXES (Amended by Act No.14474, Dec. 27, 2016)
- ENFORCEMENT DECREE OF THE ADJUSTMENT ACT OF INTERNATIONAL TAXES (Amended by Presidential Decree No. 27958, Mar. 27, 2017)

Definition of related party

The term “foreign related party” means a nonresident, foreign corporation or his/her/its foreign business place, which has a ‘special relationship’ with a resident, domestic corporation, or domestic business place.

The term “special relationship” means a relationship falling under any of the following items, and the detailed criteria thereon shall be prescribed:

1. A relationship in which either party to a transaction owns directly or indirectly 50 percent or more of the voting shares of the other party;
2. A relationship between both parties to a transaction, in cases where a third party owns directly or indirectly 50 percent or more of the irrelative voting share;
3. A relationship in which parties to a transaction have common interests through an investment in capital, a transaction of goods or service, a grant of loan, etc. and either party to a transaction has a power to actually make a decision on the business policy of the other party;
4. A relationship between both parties to a transaction, in cases where the parties to the transaction have common interests through an investment in capital, a transaction of goods or service, a grant of loan, etc. and a third party has a power to actually make a decision on the business policies of both parties.

Treatment of the OECD Guidelines

South Korea is a member of the OECD. The South Korean TP regulations are largely based on the OECD Guidelines. Since 2016, the Ministry of Strategy and Finance introduced Integration Reporting System according to the OECD’s prevention plan against BEPS.

Accepted TP methods and priority

The arm’s length price shall be calculated by the most reasonable method from among those falling under any of the following subparagraphs: Provided that the method under subparagraphs (6) shall be limited to the case where the arm’s length price may not be computed by the methods under subparagraphs (1) through (5):

1. Method with a comparable third party's price: A method with regard to a trade price between the independent unrelated parties in a trade situation similar to the relevant trade, as the arm's length price in the international trade between a resident and a foreign related party. (OECD Guidelines' CUP Method)
2. Method with a resale price: Where a resident and a foreign related party trade the asset, and then the purchaser of the relevant asset, who is one party to such trade, resells it to the unrelated parties, a method with regard to the amount computed by deducting the amount viewable as normal profits of the purchaser from such is the sale price, as the arm's length price. (OECD Guidelines' RPM)
3. Cost plus method: A method with regard to the price computed by adding the amount viewable as normal profits of the seller of the asset or the service provider to the cost incurred in the course of production or sale of the assets or provision of service, as the arm's length price in the international trade between a resident and a foreign related party. (OECD Guidelines' Cost Plus Method)
4. Profit sharing method: Within international trade between a resident and a foreign related party, the net trade profits realised by both parties are allocated according to the level of relative contribution between the parties to trades, which has been measured by the allocation criteria provided in each of the following items, and then the trade price, which has been computed on the basis of the profits allocated in such a way, shall be deemed the arm's length price. (OECD Guidelines' PSM)
 - a). Relative value of assets used and risk level taken,
 - b). Operative asset, fixed or unfixed asset, and Capital expenditures used,
 - c). Level of expenditures for core area such as R&D, design, marketing;
 - d). Other measurable rational allocation criteria;
5. Net trade profit ratio method: Method of regarding a trade price calculated on the basis of net trade profit ratio prescribed in the following items, which has been realised in a trade similar to the trade concerned between a resident and an unrelated party, as the arm's length price in the cases of international trades between a resident and a foreign related party: (OECD Guidelines' TNMM)
 - a). Net trade profit ratio to the sales;
 - b). Net trade profit ratio to the assets;
 - c). Net trade profit ratio to sales cost and sales expense;
 - d). Ratio of gross sales profit to sales expenses;
 - e). Other net trade profit ratio deemed to be reasonable;
6. Other methods deemed rational in view of the substance and practice of trades (i.e., unspecified methods).

Documentation requirements

A taxpayer engaged in international trades with a foreign related party shall submit a specification of such international trades as provided by the Ordinance of the Ministry of Strategy and Finance by the time limit for filing a tax return to the head of the tax office, having jurisdiction over the tax payment place.

1. A taxpayer having total sales or transaction size between relative parties larger than Presidential Decree's regulation shall further submit consolidated corporate information report, individual corporate information report and report by country by the time limit of 12 months from the end of accounting period.
 - company sales over 100 billion Won and transaction between relative parties over 50 billion Won per annum, or
 - company's consolidated total sales is over 1,000 billion Won per annum
- 2). The South Korean TA may request the taxpayer to submit the related data, such as the computing method of trade prices, etc.
- 3). Any person in receipt of a request for data submission shall submit the relevant data within 60 days from the date of receiving the request for data submission.
- 4). Documents should be prepared and submitted in Korean. English translations may be used only under permission of the South Korean TA.
- 5). There is no specific provision governing SMEs.

Tax audit procedure

In general, the National Tax Service ("NTS") reviews corporate income tax returns, including TP-related documentation, to identify taxpayers who display signs of noncompliance with TP regulations. The NTS then requests additional information from suspected taxpayers for review. Taxpayers who fail to submit TP-related data required are more likely to be selected for an audit.

Income adjustment, surcharges, and penalties

1. When a resident makes an agreement with a foreign related party on the allotment of cost, expense, risk for the joint development, or securing of an intangible asset and carries on such joint development, the South Korean TA may adjust the cost, etc. allotted to the resident based on the allotted arm's length cost to determine or rectify the taxable base and tax amount of the resident, if the cost, etc. allotted to the resident is less or more than the allotted amount of the arm's length cost.
2. When a resident determined shares of participants after reasonably allotting the cost, etc. for an intangible asset jointly developed with a foreign related party, but the benefits expected from the jointly developed intangible asset are subsequently changed at a rate equivalent to or more than that prescribed by Presidential Decree, the South Korean TA may determine or rectify the tax base and tax amount of the resident by adjusting the shares of the participants based on the expected benefits as changed.
3. Penalties include an underreporting and non-reporting penalty (10 percent of CIT assessed) and a non-paid penalty (10.95 percent per annum). On top of these penalties and taxes assessed, a residential surtax (10 percent) is also imposed.

Advance pricing agreements

1. A resident may, when he/she intends to apply the arm's length price computation method to the taxable years for a specific period, file an application for approval to the Commissioner of the NTS not later than the end of the first taxable year for a specific period in which he/she intends to apply the arm's length price computation method.
2. The Commissioner of the NTS may, when a resident applies for approval for the arm's length price computation method, grant approval for such method, if agreed with the CA of the Contracting State through MAP.
3. A resident can file an application for approval for the retroactive application of the arm's length price computation method for the taxable year before the period is subject to the application. The Commissioner of the NTS may grant approval for such a retroactive application unless the period for exclusion from the assessment of national taxes has expired.
4. Where the arm's length price computation method is approved, a resident shall submit a report containing the arm's length price computed according to it, procedures of computation, etc. to the Commissioner of the NTS.

Ex post measures to prevent double taxation

The ADJUSTMENT OF INTERNATIONAL TAXES ACT and the accompanying PRESIDENTIAL ENFORCEMENT DECREE contain detailed information about MAPs, which taxpayers may use to seek relief from double taxation.

Contact information

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Spain



Statutory rules/laws

- 1.1 Royal Legislative Decree (“RD”) 4/2004, of 5 March, approving the revised text of the law on CIT (Articles 17, 18, and 19)
- 1.2 RD 1777/2004, of 30 July, approving the CIT Regulation (“RIS”, its acronym in Spanish)
- 1.3 Article 42 of the Commercial Code
- 1.4 The purpose of Law 36/2006 of 29 November, on measures for the prevention of tax fraud, was to adapt Spanish legislation on TP, establishing a new framework in relation to related transactions. The legislation establishes the obligation of the taxpayer to assess transactions between related persons or entities at market price (i.e., arm’s length).
- 1.5 RD 1794/2008 of 3 November issued an amendment on corporate income tax, with the intention of approximating tax rules to accounting after the divergences generated by the publication of RD 1514/2007, through which the General Accounting Plan that regulates transactions between companies in the same group was approved, and in which the obligation to assess them at fair value is established.

As a result of the obligation described above, it is imperative that Spanish taxpayers analyse and, if necessary, modify the transfer prices established for related transactions, as well as proceed to document them, as required by the Spanish regulations.

Definition of related parties

Spanish Corporate Tax Law enumerates the cases when a transaction is being held between related parties:

- An entity and its participating shareholders (and their family members, related by kinship in direct or collateral line to the third degree of consanguinity. If this linkage is defined in terms of the partner and shareholder relationship, participation should be above of 25 percent).
- An entity and its Directors or the members of its Board of Directors shareholders (and their family members, related by kinship in direct or collateral line to the third degree of consanguinity)
- Two entities belonging to a group according to the definition given by the Article 42 of the Commercial Code.
- An entity and the partners and shareholders of another entity, where both entities belong to a group.
- An entity and the directors or managers of another, where both belong to a group.
- An entity and the spouses or persons related by kinship in a direct or collateral line by blood or affinity to the third degree of the participating members of another entity (excluding its directors and managers), if both belong to a group.

- An entity and another entity in which the first has an indirect interest in at least 25 percent of the share capital or own funds.
- Two entities in which the same members, shareholders or their spouses, or persons related by kinship in direct or collateral line by consanguinity or affinity to the third degree, have an interest, directly or indirectly, in at least 25 percent of the share capital or own funds.
- An entity in Spanish territory and its PEs abroad and vice versa.

Treatment of the OECD Guidelines

Spanish regulations use the term “open market value” in reference to the ‘arm’s length principle’ to govern and guide in TP matters, and therefore, adopt the approaches and recommendations of the OECD Guidelines.

Accepted TP methods and priority

To determine the fair market value (i.e., TP), one of the methods referred to in Article 18.4 of the law on corporate income tax (“TRLIS”, its acronym in Spanish) shall be applied. Fair market value shall be understood as the value which would have been agreed between independent persons or entities under conditions of free competition. Spanish TP regulations adopt the TP methods prescribed by the OECD Guidelines.

To determine the valuation method to be used, the TRLIS intends to carry out a comparability analysis that will compare the circumstances that exist between transactions and related entities to the circumstances between independent persons or entities.

Documentation requirements

There are three local documentation requirements in Spain:

- **CbC information:** Should be submitted by the group’s dominant entity (i.e., ultimate parent). If the dominant entity is Spanish resident, the information will be exhaustive, showing the total group revenue, the intra entities revenue, group profit before corporate tax, corporate tax paid, etc. If the dominant is a non-Spanish tax resident, the dominant entity identification and the country where the information has been presented should be disclosed. The deadline for submitting this document is 12 months after the tax closing period.
- **Information to be disclosed in the Corporate Tax Return:** For the tax periods started on the 1st of January 2016, there is a new obligation in order to submit the information that should be sent with the Corporate Tax Return, in a new form (232 return). The deadline for submitting this document is the last day of the 11th month after the closing of the tax period. The document should show the operations between the related parties, the identification of the entities, the amounts invoiced, and the valuation method (TP method) used.

- **Determination of fair market value (comparability analysis):**

Whether the transfer prices between related parties is comparable to prices between independent persons or entities shall be determined using the following:

- The specific characteristics of the good or services.
- Any other circumstances relevant to each case, such as trade strategies.
- An analysis of the functions undertaken by the parties in connection with the analysed transactions shall be conducted, identifying the risks assumed and considering, if any, assets used.
- The contractual terms from which, where appropriate, the transactions derive, taking into account the responsibilities, risks and benefits assumed by each contracting party.
- The characteristics of the markets in which the goods are delivered or services are rendered or other factors that may affect related transactions.

Having a correct comparability analysis and enough information on comparable transactions constitute the appropriate tools for determining the optimal valuation method.

1. Documentation obligation of the group to which the taxpayer belongs:

- General description of the organisational, legal and operational structure of the group, as well as any relevant change in this structure.
- Identification of different entities which, as part of the group, carry out linked transactions as they affect, directly or indirectly, the transactions carried out by the tax obligor.
- General description of the nature, amounts, and flows of related transactions between entities of the group as they affect, directly or indirectly, the transactions carried out by the tax obligor.
- General description of the functions performed and risks assumed by the different entities of the group as they affect, directly or indirectly, the transactions carried out by the tax obligor, including changes from the previous tax period or liquidation.
- An account of the ownership of patents, trademarks, trade names, and other intangible assets as they affect, directly or indirectly, the transactions carried out by the tax obligor and the amount of the considerations arising from their use.
- A description of the group's TP policy that includes the price fixing method or methods adopted by the group, justifying its compliance with the arm's length principle.
- A list of cost-sharing agreements and contracts for services between entities of the group, as they affect, directly or indirectly, the transactions carried out by the tax obligor.
- A list of previous price agreements (APAs) or MAPs concluded or under way relating to the entities of the group when they directly or indirectly affect, the transactions carried out by the tax obligor.
- Financial statements of the group or, if failing to file this, an equivalent annual report.

However, these documentation requirements shall not be required for groups whose immediately preceding tax period has not exceeded €8 million.

2. Documentation requirements for taxpayers are:

- a. Name and surnames or full trade name or company name, legal address, and tax identification number of the taxpayer and persons or entities with which the transaction is conducted, as well as detailed description of its nature, characteristics and amount. If the transaction is carried out with residents in tax havens, the persons and, when appropriate, administrators of the entities involved in the transaction must be identified.
- b. Comparability analysis under the terms described in Article 16 of the RIS.
- c. An explanation regarding the selection of the valuation method chosen, including a description of the rationale behind the choice of the method, as well as its manner of application, and the explanation of the value or range of values derived from it.
- d. Criteria for allocating expenses for services provided jointly in favor of several persons or related entities, as well as the relevant agreements and cost-sharing agreements referred to in Article 17 of the RIS.
- e. Any other information the taxpayer has available to determine the valuation of related transactions, as well as shareholder agreements signed with other partners.

Documentation requirements relating to the tax obligor shall be payable in full unless one of the parties involved is an entity of small size or an individual and in both cases does not involve transactions with persons or entities resident in countries or territories considered tax havens. In such cases, the documentation requirements are not as extensive and are established depending on the specific type of transaction carried out.

Concerning the language of the Master File, it is not mandatory to keep it in Spanish, although it could happen that the Spanish TA could ask for the translation of part or the entire documentation giving a reasonable time to do it without any penalty.

Tax audit procedure

In the case of a tax audit, the review of the transfer prices should be done in a separate procedure.

If, due to different valuation of the fair market value of the operations, the taxpayer can claim against the new value. The related parties will be informed, so that they can also claim against the review, or both parts could claim jointly.

The effects of the audit resolution should be taken in consideration by the parties involved in the TP change.

Income adjustment, surcharges, and penalties

The following constitutes a tax violation:

- Not providing or providing incomplete or inaccurate documentation or false information (even if there is value adjustment).
- The market value resulting from the documentation is not the declared value.

Sanction

If valuation adjustment does not apply, a fine of €1,000 for each item and €10,000 per set of missing, inaccurate, or false data will be imposed, capped at a maximum limit of the lower of these two figures:

- 10 percent of the whole operations subject to CIT, personal income tax, and non-resident personal income tax done in the tax period.
- 1 percent of the turnover of the tax period.

If valuation adjustment applies, a proportionate fine of 15 percent of the adjusted amount will be imposed (even if there is no economic damage).

Advance pricing arrangements

APAs are prior arrangements defined by the OECD, which in advance of controlled transactions determines an appropriate set of criteria for determining TP for those transactions over a fixed period of time. APA on TP can be unilateral, involving a single TA; or a single or multilateral taxpayer, involving the agreement of two or more TAs (bilateral or multilateral APA).

Therefore, APAs are a model for international termination of the verification procedure of the market value in transactions. In other words, this is a prior agreement, reached between the TAs and taxpayers, which determines in advance, and for a longer or shorter term, the market price applicable to each transaction.

It is possible to voluntarily claim for APAs to the Spanish TA.

Ex post measures to prevent double taxation

The Spanish TA signed onto the MLI on the 7th of June 2017, which will allow the implementation of new measures to avoid BEPS.

Spain has included these new measures in most of the Tax Treaties already signed, just leaving apart those that are currently being renegotiated.

Corporate Tax Spanish domestic rules allow the deduction of the Tax paid abroad, to prevent double taxation.

Nevertheless, for periods started on the 1st of January 2016, the deduction will just be 50 percent for entities whose turnover is above €20.000.000 on a yearly basis.

Intercompany financing

The Spanish TP regulations relevant to loan and guarantee transactions do not set forth specific methods for evaluating the arm's length nature of the TP. There are specific limitations on interests between related parties:

- When the loan is given by a company group for the acquisition of the shares of another company group, the interest cost is not deductible, unless it is demonstrated that the operation corresponds to an economical reason.
- The interest from a loan lent by a related party will not be deductible if the borrower is not taxed at a tax rate of over 10 percent in its home country.

Safe harbour provisions/exceptions for SMEs

There are no such provisions under the Spanish regulation.

TP and PEs (AOA)

The regulation on TP is also applicable for the transactions between the entity and its PE.

The revenues obtained by a PE abroad will be tax-free in Spain if the PE is taxed at a rate over 10 percent with a similar obligation in the country where the PE is located.

Contact information

For more information and TP related issues in Spain, please contact:

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Sweden



Statutory rules/laws

a. Laws

- Inkomstskattelagen ("Income Tax Act") Chapter 14, Sections 19-20, regarding the arm's length principle.
- Skatteförfarandelagen ("Tax Procedure Act") Chapter 39, Sections 15-16, regarding the documentation requirements in TP situations.

b. Statutory ordinances/regulations

- Skatteverkets föreskrifter om dokumentation av prissättning mellan företag i intressegemenskap (Swedish Tax Agency's regulations on documentation of TP between associated enterprises), "SKVFS 2007:1", or the English translation "SKVFS 2007:01B").
- Skatteverkets information om dokumentation av prissättning av transaktioner mellan företag i intressegemenskap. (Swedish Tax Agency's information on documentation of pricing of transactions between companies in an interest group). "SKV M 2007:25".

Definition of related party

Companies with cross-border transactions with related companies are affected by these rules and regulations.

- Swedish companies with ownership of more than 50 percent in a foreign related company must be able to have documentation regarding their international transactions.
- Foreign companies with ownership of more than 50 percent in a Swedish company also must be able to have documentation regarding their international transactions.
- The same rules are valid in situations such as transactions within non-real company groups or transactions between sister companies. However, PEs are not included by the rules regarding their contacts with its own main office.

Treatment of the OECD Guidelines

Generally, the OECD Guidelines are adopted in Sweden. However, according to the Swedish Tax Agency, parts of the Swedish law do not match the OECD Guidelines. One part deviates regarding the sectioning of the documentation made by the OECD Guidelines, some of which should be used jointly for all companies in a company Group, while another part refers to the individual company's transactions. The current Swedish legislation also contains no exceptions to the obligation to document, not even for the smallest companies. At the same time, the current Swedish legislation does not cover all the companies that should have documentation under the OECD Guidelines. This applies, for example, to foreign companies operating through a PE in Sweden. The OECD Guidelines' new standard is also much clearer than the current Swedish legislation in terms of specifying what the documentation should contain.

The Swedish Tax Agency's assessment is that changes to the Swedish law are required to ensure that the Swedish documentation rules comply with the OECD Guidelines' and include the range of companies that, according to the OECD Guidelines, should be governed by the acquis.

Accepted TP methods and priority

The arm's length principle is the fundamental principle in relation to TP. The principle means that commercial and financial transactions shall be based on the same terms and conditions that would have been applied between independent enterprises. It is the conditions of the market that shall affect the pricing methods. This requires that different transactions are comparable with each other. There is no real priority among different methods. The arm's length principle is also near comparable with the OECD Guidelines, and the Swedish TA adopts the TP methods prescribed by the OECD Guidelines.

The comparability analysis shall (according to Section 9 in SKVFS 2007:01B) "include a description of the internal and the external comparable transactions that have been used and the basis for their selection. The analysis shall be made considering the comparability factors and any adjustments which have been made to improve the comparability. In cases where comparable transactions have not been identified, the documentation shall contain a description of how the enterprise has arrived at the conclusion that the TP method is in accordance with the arm's length principle."

Documentation requirements

Special TPD requirements exist in Sections 3-6 in SKVFS 2007:01B.

Filing deadline

The documentation shall be submitted to the Swedish Tax Agency at the request of the Agency and may be made after the date on which the tax return for the financial year concerned shall be submitted. After that, the enterprise shall be given the opportunity to comply with such a request within a reasonable time.

The documentation shall be filed for ten years after the end of the calendar year in which the financial year came to an end (Section 14).

Mandatory language

The documentation shall be in Swedish, Danish, Norwegian, or English (Section 13).

Alignment with new Ch. V of OECD Guidelines/BEPS Action 13

According to SKVFS 2007:01B, TPD must include the items listed below in order to satisfy penalty avoidance requirements. There is no direct reference to the requirements in OECD Guidelines, Ch V. However, in practice, there is substantial overlap between the Swedish and the OECD Guidelines' documentation requirements.

- A description of the legal structure of the enterprise group, showing the ownership structure and the manner in which the enterprise controls, or is controlled by, other enterprises in the enterprise group (Section 3).

- The business structure and the business from an operational perspective of the enterprise and the enterprise group shall be presented and major changes in the enterprise and the enterprise group during the financial year shall be described. (Section 3).
- Financial information that is relevant to the application of the chosen TP method for the financial year with regard to the enterprise and the other enterprises within the enterprise group with which the enterprise has had transactions during the financial year (Section 4).
- Information on industry-specific conditions and the business model, which has affected the enterprise's pricing of intra-group transactions. (Section 4)
- A description of the enterprise's intra-group transactions in relation to each of the enterprises with which the transactions have occurred, either transaction by transaction or in an aggregated form. The transactions shall be described based on the comparability factors and the description shall, inter alia, include information on:
 1. type of transaction,
 2. value,
 3. volume,
 4. other contractual terms and conditions,
 5. any connection with other transactions which is significant to the pricing, and
 6. costs incurred, allocation key and mark-up attributable to cost-based, indirect charging for intra-group services provided." (Section 5)
- The agreements which are important for the pricing or a compilation of such agreements (Section 6).
- A description of the various main categories of agreements into which the enterprise has entered, and the TP methodology applied in those agreements (alternative for enterprises with a large number of agreements), (Section 6).
- Agreements and other arrangements governing matters related to TP, into which the enterprise or another enterprise within the enterprise group has entered with any authority and which affect the enterprise shall be reported. The documentation shall also contain advance rulings and other similar notifications from abroad regarding matters of TP, which affect the enterprise (Section 6).

The Tax Procedure Act, Chapter 39, also describes that the documentation shall both include an intercompany part and a company specific part. Also, the Tax Agency has described this in detail in its legal guidance regarding TPD.

For intra-group transactions of minor value, the documentation may contain a simplified report compared to the information required in the Tax Return and Statements of Income Act Chapter 19, Section 2 b, first paragraph. "Transactions of minor value" refers to transactions with goods where the total market value does not exceed 630 "price base amounts" per enterprise within the enterprise group as well as other transactions where the total market value does not exceed 125 "price base amounts" per enterprise within the enterprise group" (Section 10). For 2017, 1 "price base amount" = SEK 44.800.

The simplified report documentation shall, according to Section 10 in the annex in SKVFS 2007:01B, contain the following information:

1. the legal structure of the enterprise group as well as the business structure and the business of the enterprise and the enterprise group,
2. the counterparty in the intra-group transaction and information about its business,
3. the transactions in question, stating the type, scope and value,
4. the method used to establish that TP of the intra-group transactions is on an arm's length basis, and
5. any comparable transactions that may have been used.

Documentation prepared according to the code of conduct on TPD for transactions between associated enterprises in the European Union (i.e., "EU TPD"), and which satisfies all the terms and conditions stated therein, shall be regarded as having been prepared in accordance with these regulations (Section 15).

Sweden is also following the BEPS Project and these resulting reports of the project shall create a common internal-level approach and contain minimum standards agreed by the OECD member states. They also include recommendations for how national legislation can be designed to counter international tax planning. The report shall include a (common) Master File, a Local File, and a CbCR.

The Swedish Parliament decided on March 1, 2017 to amend the TPD rules. The amended legislation means that Sweden is obliged to submit a CbCR for financial years that has begun after December 31, 2015. Swedish companies that are part of a group covered by the reporting obligation shall also notify the Swedish Tax Agency accordingly. TPD shall consist of a group common part and a company-specific part. These changes apply to financial years commencing on 31 March 2017. Current provisions apply for fiscal years commencing before April 1, 2017. Sweden will not receive country-by-country information from other countries from 2018, and the Swedish Tax Agency will not use CbCR to make a decision on taxation in an individual case.

Tax audit procedure

The tax audit process in Sweden is described in the letter SKV 663B edition 1 from the Swedish Tax Agency.

An audit means that the Swedish Tax Agency has decided to examine the information that has been provided as the basis for e.g. a tax return. The purpose of an audit is to ensure that the taxpayer will pay exactly the amount of tax that the taxpayer is obliged to pay by law. It is solely the Swedish Tax Agency that may decide on an audit on the basis of the Swedish Tax Procedure Act. The audit may include one or more items of information covering a period ranging from one month to several years.

The documentation shall be submitted to the Swedish Tax Agency at the request of the Agency. Such a request from the Agency may be made after the date on which the tax return for the financial year concerned shall be submitted. The enterprise shall be given the opportunity to comply with such a request within a reasonable period of time. The documentation may be submitted as a hard copy or electronically." (Section 12 in SKVFS 2007:01B)

The Swedish Tax Agency ends the audit procedure by drawing up an audit memorandum that the taxpayer is served with afterwards. This details the time period that was examined and what the examination revealed. If the Agency proposes changing the tax as a result of the audit, the taxpayer will be permitted to leave comments on the audit memorandum. Normally, requested documentation shall be provided to the Agency within 30 days.

The Swedish Tax Agency is continuing to work with a big focus and high priority on TP cases, especially regarding the new BEPS Project. Special focus areas are financial transactions, acquisition transactions, goods and services trading, restructurings and profit/loss allocations, and arrangements between enterprises and between group enterprises. The Swedish Tax Agency has experts and dedicated TP auditors and litigators, working preferably with TP cases based at the offices in Stockholm, Gothenburg, and Malmö.

Income adjustment, surcharges, and penalties

If TP does not conform with the general tax rules or if incorrect information results in an incorrect tax bases, the Swedish tax Agency can decide on adjustments.

Sweden has no special TP penalties. If a tax adjustment, also due to TP cases, is sustained, general tax penalties is the case, i.e. as high as 40 percent of the additional tax depending on the adjustment. Penalties might be avoided if complete required documentation could be delivered together with the annual income tax return. The penalty also depends on what kind of adjustment has been made and regarding what kind of tax the adjustment refers to. Final tax has a higher penalty than other taxes. Additional tax and penalties become relevant if incorrect information have resulted in withholding tax.

If penalties are not paid by the payment date, interest may also be charged.

Advance pricing agreements

- Lag (2009:1289) om prissättningsbesked vid internationella transaktioner (APA Act).
- Förordning (2009:1295) om prissättningsbesked vid internationella transaktioner (APA Regarding International Transactions Regulation).

Since 1 January 2010, the Swedish Tax Agency is the CA when applying for APAs. An APA is based on an agreement between two or several countries and is about how different international transactions shall be made and comprises normally three to five financial years. For this agreement to be announced, it is necessary that Sweden has a Tax Treaty(ies) with the country or those countries it relates. The agreement shall also include provisions that enable interchange of information between the countries. The APA is used when deciding the base for state and local income tax.

An APA may not concern a non-complicated question, it may not relate to transactions minor and the transaction must be independently evaluated. An APA is normally binding for the Swedish Tax Agency under comparable conditions. An APA can, however, under certain conditions, be changed or revoked.

All traders, now taxable or in the future expected taxable, both Swedish and foreign with PE in Sweden according to the Income Tax Act, can apply for an APA.

The fee for applying is per country SEK 150.000 for a new APA, SEK 125.000 for a renewal with amendments, and SEK 100.000 for a renewal without amendments.

Section 5 in the APA Regarding International Transactions Regulation lists all data requirements for the application. Those requirements are parallel to the TP methodology.

The application for an APA shall be sent to: The Swedish Tax Agency/Head office, CA, Legal section, 171 94 Solna, Sweden.

Ex post measures to prevent double taxation

The Swedish Tax Agency is also the CA regarding negotiations with other countries to prevent double taxation or taxation contrary to current tax treaties.

When a Swedish taxpayer feels that the taxation has resulted in double taxation or is against current Tax Treaties, the taxpayer can ask for help from the Swedish Tax Agency, free of charge. The taxpayer also can reply for respite with paying the suspected double tax during the case processing time. However, between Sweden and India there is a certain agreement regarding the possibility to get respite during the processing time, especially for the respite in India. For more information, see attachment 2 in the law regarding the double taxation agreement between Sweden and India.

During the process, the Swedish Tax Agency, together with the other country's CA, tries to find a solution through a mutual agreement. The taxpayer is not a part in these negotiations, but still has an opportunity to comment the discussed details. During the process, the taxpayer also can be prompted for incoming with completed information.

It is an advantage to apply and ask for this help as early as possible, to avoid a prescription in the other country. According to several of Sweden's Tax Treaties (normally based on the OECD Tax Treaty) an application must be made within three years from the time when the taxpayer was informed about the action resulting in taxation in conflict with the tax treaties. It is always important to do a careful study of the tax treaties in every special situation.

The application for a payment respite during the processing time shall be sent to: The Swedish Tax Agency/ Head office, CA, Legal section, 171 94 Solna, Sweden.

Intercompany financing

The general approach in Sweden regarding TP and financing transactions is the arm's length principle. Prices must be set as if transactions take place between two independent companies.

Regarding intercompany transaction, it is very important to determine the classification of the transaction. Is, for example, a transaction a loan or a contribution? What are the conditions and the intention of a transaction, and how has the transaction been booked in the accounts? In Sweden, regarding to the Tax Agency and based on practise we still have loans between companies instead of re-characterisation of transaction into equity.

Intercompany interests shall basically be calculated in the same way as interests between independent companies. Therefore, the comparability analysis for following the arm's length principle is useful.

Interest costs in a company are normally deductible, also regarding loans between companies, within or outside intercompany transactions. However, taxpayers have to analyse and secure the deductibility of interest costs regarding foreign intercompany transactions, especially so that the arm's length principle is sought.

Generally, a loan written off is considered income to the borrower. However, exceptions may apply.

Safe harbour provisions/exemptions for SMEs

As described in section five above, for companies with smaller transactions value, there are simplified documentation rules. The amount for purchase and sale of goods is maximum 630 Swedish price base amounts. The amount for other kind of transactions is maximum 125 price base amounts. However, companies always have to document transactions which relate to the transfer of intangible assests, regardless of value, as the simplified documentation rules do not apply. The simplified documentation rules are described more in SKVFS 2007:01B.

TP and PEs (AOA)

A foreign company, whose business activity in Sweden is covered by the Branch Act, is liable for accounting for its activities. This applies regardless of whether the branch has been registered in the branch register or not. A Swedish or foreign citizen/company who/which lives abroad but is engaged in business activities in Sweden is, accounting to the Branch Act, liable for accounting in Sweden for the business.

The accounting for the Swedish operations should be separate from the accounts for operations abroad and is to be kept in Sweden. The way in which the accounting obligation is to be met is stated in the Accounting Act and by the Board of Accounting.

There is also a general documentation obligation for those who pay taxes and fees in Sweden. This implies that the branch which is required to submit income tax returns in Sweden is obliged to make sure that there is a basis for the accounting and tax compliance through the accounts and that the tax basis is able to be controlled by the Swedish Tax Agency.

Contact information

For more information and TP related issues in Sweden, please contact:

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For more specific information or for information of other questions the contact information to the Swedish Tax Agency is www.skatteverket.se or by phone from abroad +46-8-564-851-60.

Switzerland



Statutory rules/laws

a. Laws

Switzerland does not have a specific TP legislation. According to Article 58 of the Federal Direct Tax Act, as well as Article 24 of the Harmonisation of the Cantonal Tax Laws Act, expenses are required to be commercially justified to be tax deductible. Based on these Articles, the Swiss TAs are allowed to make profit adjustments in case of deviations from the arm's length principle.

As per December 1, 2017, a new law was enacted that obliges Swiss based MNEs with a consolidated turnover of at least CHF 900 million to file a CbCR according to BEPS Action 13.

b. Circular letters

- Circular Letter No. 6 of 6 June 1997:

Safe harbour regulations regarding intercompany loans and thin capitalisation.

- Circular Letter No. 4 of 19 March 2004:

Taxation of intra-group service companies at cost plus.

Definition of related party

No specific definition of related party and there are no formal related party disclosure requirements. The Swiss TAs generally follow the OECD's definition of "associated enterprises".

Treatment of the OECD Guidelines

Switzerland, as an OECD founding member, has accepted the initial as well as all the updated OECD Guidelines without reservation.

Accepted TP methods and priority

The Swiss TAs generally accept the methods specified by the OECD Guidelines. For intra-group service companies, the Cost Plus Method is to prefer (Circular Letter No. 4 of 19 March 2004).

Documentation requirements

With the exclusion set out below, there are no documentation requirements. However, if the Swiss TAs question the applied transfer prices, the taxpayer has to demonstrate that the transfer prices were based on sound economic and commercial reasoning on an arm's length basis. Therefore, it is advisable to prepare supporting documents.

On December 1, 2017, a new law was enacted that obliges MNEs with a Swiss resident parent company and a consolidated turnover of at least CHF 900 million to file a CbCR according to BEPS Action 13 for the first time for fiscal year 2018. However, if local tax laws of subsidiaries require to file a report for earlier years, the Swiss parent is allowed to file a report on a voluntary basis.

Tax audit procedure

Transfer prices may be audited during ordinary assessment of the taxpayer by the Swiss TAs, which may ask for additional information within generally 30 days (extension of deadline is usually granted).

Income adjustment, surcharges, and penalties

There are no specific penalties regarding TP, and general penalties are applicable:

- Tax on profit adjustment must be paid with interest charge for late payment. Adjustments may qualify as a deemed profit distribution subject to Swiss withholding tax (up to 53.8 percent).
- Penalty rules generally only apply in case of fraud or negligence. Penalties are usually in the range of 100 percent to 300 percent of the tax payable on the profit adjustment. Penalties are not tax deductible.

Advance pricing agreements

There are no formal APA procedures. However, transfer prices could be agreed based on a tax ruling, which are very common in Switzerland and may be granted within 2 to 6 weeks. The Swiss TAs do not levy a charge for granting tax rulings.

Ex post measures to prevent double taxation

In case of a TP related income adjustment, the taxpayer has the possibility to appeal against that adjustment within the national appeal procedure. Once the adjustment is final, the taxpayer could apply for a MAP according to Art. 25 of Model Treaty to prevent double taxation in case of TP related income adjustment.

Intercompany financing

The Swiss tax law requires that a company is properly equity financed. The Swiss TA has issued a circular letter dated 6 June 1997 reflecting safe haven rules of how an appropriate debt to equity ratio is to be calculated.

This circular letter states that the maximum amount of acceptable debt financing must be determined on the basis of applying specific percentages on the fair market value of different asset categories, e.g.:

| | |
|-------------------|-------|
| Cash | 100 % |
| Receivables | 85 % |
| Loans | 85 % |
| Participations | 70 % |
| Intangible assets | 70 % |

Consequently, the required debt to equity ratio depends on the composition of the assets. For finance companies, the generally accepted safe haven debt to equity ratio is 6:1. However, different debt to equity ratios are accepted, if the taxpayer is able to prove that the ratio is arm's length.

In case of thin capitalisation, the debt considered as equity will be added to the taxable capital and be subject to annual net wealth tax.

In addition, interest paid to group lenders on disallowed debt is added back to the taxable income and will be qualified as a deemed dividend distribution subject to Swiss withholding tax. The same applies to interest on third party financing if the shareholder or another related party secures it.

Using an interest rate below the maximum interest rate annually published by the federal TAs may mitigate this risk (e.g. 2017: maximum interest rate for CHF loans up to CHF 1 million: 2.5 percent (holding companies) and 3.0 percent (trading and production companies); for loans exceeding CHF 1 million: 0.75 percent (holding companies) and 1.0 percent (trading and production companies)).

Safe harbour provisions/exemptions for SMEs

Since there are basically no TPD requirements, there are no exemptions for SMEs in place.

TP and PEs (AOA)

Profits of PEs in Switzerland have to be determined as if the Swiss PE was a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions. Consequentially, the same principles are applicable.

Contact information

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United Kingdom



Statutory rules/laws

Tax legislation on TP is contained in Part 4, sections 146-217, of the Taxation of International and Other Provisions Act 2010 (“TIOPA 2010”). Recent amendments to TP guidelines articulated by Action points 8-10 of the OECD BEPS project are also part of UK tax law.

Her Majesty’s Revenue and Customs (“HMRC”), UK’s TA, has published its interpretation of the TP legislation in paragraphs INTM410000 – INTM510000 of its International Tax Manual, which is routinely updated and is a useful resource to understand the practical application of TP regulations.

Definition of related party

Two parties are deemed to be related, for TP purposes, where the ‘participation’ condition is met at the time of the relevant transaction or in the following six months (s.148 TIOPA 2010). This is where:

- one directly or indirectly participates in the management, control, or capital of the other
- the same person(s) directly or indirectly participates in the management, control, or capital of both.

Control is the power to secure the affairs of an entity in accordance with a person’s wishes.

Direct participation is where a party meets the 51% test of control (commonly in reference to shareholding).

Indirect participation is where a person has future control rights, or rights that are exercised under his instructions, or for his benefit, or where he is a major participator in a company.

A person is a **major participator** when two people taken together exercise control over a company and each holds at least 40 percent of the rights.

In applying the tests above, rights held by connected persons must also be considered. These are spouses, relatives, relatives of spouses, and spouses of relatives. Relatives include siblings, ancestors, and lineal descendants.

Treatment of the OECD Guidelines

The UK fully complies with the transfer pricing guidelines issued by the OECD. Section 164 of TIOPA 2010 prescribes that TP legislation is to be ‘construed in a manner that best secures consistency with the arm’s length principle under Article 9 of the OECD’s model treaty and its TP Guidelines (as updated for the BEPS outcomes).

Updates to the OECD Guidelines are routinely imported into UK law, and HMRC will also use the OECD Guidelines in analysing an entity’s transfer prices.

Accepted TP methods and priority

The OECD Guidelines (as expanded by BEPS Actions 8-10) continue to be an objective framework, as far as HMRC is concerned, to establish TP methods that are in accordance with the arm's length principle.

As the overarching objective of the OECD Guidelines is to establish a price for related party transactions to be the same as it would have been between unconnected parties, any 'other' methods outside of the five outlined by the OECD Guidelines may also be acceptable to HMRC, so far as the arm's length objective is achieved.

HMRC, in following with the OECD Guidelines, however, prefer the traditional transaction methods over transactional profit methods where both can be applied in an equally reliable manner. Similarly, there is a preference for the CUP Method over others – but equal emphasis is placed on the use of the most appropriate suitable to the transaction.

Documentation requirements

The UK tax system follows the principles of self assessment so taxpayers ought to have sufficient records to enable them to complete their tax returns correctly. It is important, however, to hold documentary evidence that demonstrates how the taxpayer has applied the arm's length principle between related parties and how (if any) TP adjustments are arrived at.

BEPS Action 13 (now part of UK tax law), has standardised the documentation requirements into three tiers:

1. A CbCR containing data on the allocation of a multinational entity's revenue, profits, taxes, employee numbers, capital, retained earnings and tangible assets for each tax jurisdiction that it operates in.

The CbCR will be filed by the UK resident's ultimate parent entity of a multinational group where consolidated group revenue exceeds €750 million. It applies to accounting periods commencing on or after 1 January 2016, and companies will have 12 months from the end of the accounting period to file a report with HMRC.

The measure also includes a requirement for the top UK entity to file a CbCR when it is not the ultimate parent entity, and the ultimate parent entity is resident in a country that either does not require CbCR or does not exchange reports with HMRC. There is an exemption if the results the UK entity have already been included in a CbCR that HMRC can receive.

2. A Master File prepared at the ultimate parent level, containing information on the entity's global operations
3. A Local File prepared by each local entity, comprising an analysis of how the arm's length principle has been applied in that particular jurisdiction

HMRC can levy a penalty of up to £3,000 if an entity does not maintain the above documents or fails to produce appropriate evidence of how it has assessed TP issues.

Tax audit procedure

TP audits (“HMRC enquiry”) are only initiated after a thorough screening of the ‘business case’ for opening an enquiry. This is a staged approach, where:

- the tax office assigned by HMRC to the taxpayer will initially identify a TP issue
- it then contacts the TP Unit, which assigns a TP specialist
- a more detailed risk assessment is then carried out to appraise if an enquiry is necessary
- if the conclusion is that an enquiry is justified, a ‘business case’ is prepared and submitted to the TP Panel, which then approves whether an enquiry should be opened or not
- if the decision is to open an enquiry, the relevant tax office will issue an ‘enquiry notice’ which formally initiates the process

During the enquiry, HMRC will seek to establish the facts of the case and seek representations (and documentation) that supports that taxpayer’s view. Following this, views are exchanged and an overall argument is developed on whether a TP adjustment is justified. This is reported back to the TP Panel which ultimately decides whether the case should:

- be closed without adjustments
- be settled by negotiation, or
- proceed to litigation

HMRC’s target will be to settle the enquiry within 18-36 months of the case being opened.

Income adjustment, surcharges, and penalties

Following an enquiry, if it transpires that a TP adjustment is required, the taxpayer can potentially be exposed to penalties and interest on the tax that was due.

The UK’s penalty regime is a behaviour-based system and applies to all taxes in mostly a uniform way. In the case of TP adjustments, the penalties to be levied would fall into two broad categories:

1. An ‘incorrect tax return’

The penalty will depend on the type of behaviour that led to the underpayment of tax (or a TP adjustment for that matter), and will be categorised as:

- 10 percent of potentially lost revenue to HMRC for non culpable behaviour
- 30 percent of potentially lost revenue to HMRC if the error was a careless error
- 70 percent of potentially lost revenue to HMRC if the error was deliberate but not concealed
- 100 percent of potentially lost revenue to HMRC if the error was deliberate and concealed

2. Failure to keep records

Up to £3,000 for failing to produce appropriate documentation necessary to demonstrate that the terms of connected party transactions were considered to be on arm’s length terms.

Advance pricing agreements

APAs are covered in Part 5 sections 218-230 of TIOPA 2010. APAs are available in the UK and provide certainty that the TP issues covered in the APA will not be subject to enquiry by HMRC for the period covered by the APA. There is no fee for filing an APA.

Before making a formal application for an APA under s.218 TIOPA 2010, HMRC recommends that an informal contact is made – the so called ‘expression of interest’. Only ‘complex’ cases (where there is doubt as to how the arm’s length principle should be applied) are taken through to the APA.

HMRC’s Statement of Practice 2/10 (“SP 2/10”) contain detailed guidance on best practice when considering an APA. Following the changes to TP guidelines under the BEPS Project, APAs now include a clause giving HMRC the right to terminate an APA in the event of changes to UK legislation.

Depending on whether the APA is unilateral, bilateral, or multi-lateral, the usual timeframe for obtaining an APA is 18-21 months (can be shorter in the case of a bilateral APA). The typical term of an APA is 3-5 years and the critical assumptions under-pining the APA are monitored through an ‘annual report’ filed by the entity as part of its annual tax returns.

Ex post measures to prevent double taxation

The UK signed into the MLI in June 2017 as part of BEPS Action 15. The MLI will effectively over-ride existing double tax treaties in interpreting such articles that need amendment following the BEPS recommendations. However, the UK has also made numerous representations on how the MLI will apply to some of the 130 plus tax treaties it has in place.

The UK will nonetheless adopt all articles of the MLI in respect of improving tax dispute resolution, whereby Article 17 of the MLI explicitly allows a state to make a corresponding adjustment to prevent double taxation by reducing the profits of its resident where another state (that has signed into the MLI) has made a TP adjustment.

Intercompany financing

Broadly speaking, if a company is party to a money debt, that debt is treated as a ‘loan relationship’. Where the company pays interest on this loan, this is deductible so long as the loan fulfils a qualifying purpose (mainly a test of commerciality). However, the deduction of interest is subject to a number of different tests; and one of these tests treads into the concept of TP. It is referred to as the ‘thin capitalisation’ test and applies to UK-UK loan relationships as well as cross border financing.

A company is thinly capitalised when its level of debt far exceeds its equity. HMRC’s position is that the arm’s length principle (as applicable to TP) will apply to:

- the rate of interest that is charged, and
- the amount of the loan

The interest rate agreed between related parties should be at a ‘market’ rate. Equally, the amount of the loan carried by a company should not differ to what it would have been able to borrow from an unconnected third party. These tests consider a range of factors such as the overall credit worthiness of the borrower, terms and conditions of the loan, guarantees and security involved, and an exercise to benchmark the transaction to a market equivalent.

Where it transpires that the company is thinly capitalised, an adjustment will be made to the tax deductible interest expense.

As with general TP scenarios, an advance thin capitalisation agreement (“ATCA”) can be reached with HMRC. Detailed guidance on how to apply for and enter an ATCA can be found in HMRC’s International Tax Manual INTM512000.

Safe harbour provisions/exemptions for SMEs

TP adjustments do not apply to entities that, together with their associates, qualify as an SME. The thresholds to be considered an SME are set out in EU Directive 2003/361/EC as follows:

- small enterprise – fewer than 50 employees and either turnover or assets of less than €10 million
- medium enterprise – fewer than 250 employees and either turnover of less than €50 million or assets of less than €43 million

These limits are applied on an annualised basis to the worldwide consolidated group of which the enterprise is a member. The results of its associates must also be included in determining whether it qualifies as an SME.

In addition, dormant companies, as defined by the Companies Act 2006, are also exempt.

There are some exclusions to the SME exemption:

- a. where an SME elects for the exemption not to apply
- b. where the other party to a transaction is in a territory with which the UK does not have a Tax Treaty with a non-discrimination clause
- c. where a TP notice has been issued by HMRC (medium-sized entities only)
- d. where a TP notice has been issued by HMRC to an entity that is claiming benefit under the patent box regime (small entities only)

TP and PEs (AOA)

The UK’s approach to determining a PE’s profits follows the AOA.

Section 21 of the Corporation Tax Act 2009 (“CTA09”) prescribes that the profits of a non-UK resident company that are attributable to its UK PE would be calculated as if the PE were a ‘separate enterprise’ engaged in the same or similar activities under the same or similar conditions and dealt independently with the non-UK company.

The separate entity principle equates to the requirement under UK domestic law to follow the arm’s length principle in calculating the non-resident company’s chargeable profits and to do this, HMRC will revert to the TP principles and methodology. This accords precisely with the attribution requirements laid down in Article 7 of the Model Tax Treaty.

Other topics

Diverted Profits Tax (“DPT”)

Introduced in 2015, this 25 percent (penal) tax can be levied on profits artificially diverted from the UK. The principal target of DPT were entities with little or no economic substance, or where arrangements had been put in place that avoided the existence of a UK PE. Although DPT may not apply prima facie to many organisations, the onus of notifying chargeability to DPT is on the taxpayer and the rules that define whether a company is within the scope of DPT or not are overly complicated. Therefore, a careful consideration of the DPT rules is now required in addition to general TP issues to avoid the charge (and any potential penalties for failing to notify HMRC).

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United States



Statutory rules/laws

- U.S. Internal Revenue Code (“IRC”) Sections 482 and 6662
- Referred to as the “**U.S. TP Regulations**”

Definition of related party

For TP purposes, taxpayers are considered related parties when they are “owned or controlled directly or indirectly by the same interests.” Control may include voting power, the right to appoint the majority of members of management, and the basis of contractual arrangements, but the language used is very broad and subject to interpretation. Moreover, if the IRS judges that two parties are cooperating to shift income for tax purposes, they will be considered related parties regardless of common ownership.

Treatment of the OECD Guidelines

The Internal Revenue Service (“IRS”) considers U.S. TP legislation to be consistent with the OECD Guidelines; however, the OECD Guidelines should not be relied on to support cross border TP positions from a U.S. Federal income tax perspective or in domestic applications. The OECD Guidelines may be used to demonstrate compliance with international principles to support a bilateral APA or to seek relief from double taxation through competent authority proceedings.

Accepted TP methods and priority

The U.S. TP Regulations specify methods for evaluating tangible goods, intangible property, cost sharing, and services transactions. Taxpayers may also apply unspecified methods to evaluate intercompany transactions in the event that an unspecified method provides the most reliable measure of the arm’s length price. Consistent with the specified methods, an unspecified method should take into account the general principle that uncontrolled taxpayers evaluate the terms of a transaction by considering the realistic alternatives to that transaction, and only enter into a transaction if no alternative is preferable to it. The U.S. TP Regulations do not specify methods to evaluate financial transactions, such as loans or guarantees. According to U.S. Treas. Reg. Sec. 1.482-1(c)(1), the “best method rule” (analogous to the OECD Guidelines’ “most appropriate method” approach) must be employed to determine the appropriate method to apply to each intercompany transaction. Contrary to the OECD Guidelines’ “methods hierarchy,” there is no priority of methods in the U.S. TP Regulations; the best method will be the method that provides the most reliable measure of an arm’s length result.

a. Specified methods for tangible goods transactions

For transactions involving tangible goods, similar to the methods specified in the OECD Guidelines, the U.S. TP Regulations specify the CUP Method, the RPM, the Cost Plus Method, the Comparable Profits Method (“CPM” – akin to the OECD Guidelines’ TNMM), and the PSM.

b. Specified methods for intangible property transactions

For transactions involving intangible goods, the U.S. TP Regulations specify the Comparable Uncontrolled Transaction (“CUT”) Method, the CPM, and the PSM, which are similar to the OECD Guidelines’ CUP Method, TNMM, and PSM.

c. Specified methods for cost sharing transactions

For transactions involving transfers to a cost sharing agreement (“CSA”) or platform contributions, the U.S. TP Regulations specify the CUT Method; the PSM; the Income Method, which looks at the difference in profits the non-developing party expects to realize from the CSA and the profits that it would expect to earn from a “realistic alternative”; the Acquisition Price Method, which references the acquisition price of a contemporaneous acquisition of the same intangible property from an uncontrolled party; and the Market Capitalisation Method, which references to stock market value of that property.

For the ongoing sharing of costs in a CSA, costs should be shared in proportion to each party’s reasonably anticipated benefits. The selection of the measurement of reasonably anticipated benefits should consider the unique facts and circumstances of the transaction under analysis. Common methods for measuring reasonably anticipated benefits include sales, units sold, operating profit, and non-routine profits.

d. Specified methods for services transactions

For transactions involving services, the U.S. TP Regulations specify the SCM, the Comparable Uncontrolled Services Price Method (“CUSP”), the Gross Services Margin Method (“GSMM”), the Cost of Services Plus Method (“CSPM”), the CPM, and the PSM. These methods are similar to the OECD Guidelines’ CUP Method, Cost Plus Method, TNMM, and PSM, respectively.

The SCM is an elective method that allows the taxpayer to charge for services at-cost if the services are on the list of “covered services” provided in Rev. Proc. 2007-13, or if they have a median comparable markup of seven percent or less (“low-margin services”). As an additional requirement, the covered or low-margin services must not constitute significant contributions to key competitive advantages, core capabilities, or fundamental business risks.

Documentation requirements**a. Filing deadline**

U.S. taxpayers are required to conduct all transactions in accordance with the arm’s length principle. Preparing and maintaining contemporaneous documentation that satisfies the requirements of IRC Section 6662 6(d) is the only method, other than obtaining an APA, to avoid adjustment penalties and is required for all taxpayers involved in a Cost Sharing Agreement per IRC Section 1.482 7(k). Documentation is considered contemporaneous if it is in existence **at the time the tax return is filed**.

b. Mandatory language

Although there are no formal language requirements, English is, almost always, used in practice.

c. Alignment with new Ch. V of OECD Guidelines/BEPS Action 13

According to IRC Section 1.6662-6(d), TP documentation must include the items listed below in order to satisfy penalty avoidance requirements. There is no direct reference to the requirements in OECD Guidelines, Ch. V. In practice, however, there is substantial overlap between the US and OECD documentation requirements,

- An overview of the business and legal or economic factors that affect pricing;
- The organisational structure of the business;
- All documents explicitly required by regulations, such as CSA documents;
- Description of the pricing method and a best method analysis;
- Description of alternative methods and why they were not selected;
- Description of controlled transactions and any internal data used in analysis;
- Description of comparables used, how comparability was evaluated, and any adjustments made;
- The economic analysis and projections used to develop pricing;
- Material data discovered after the close of the tax year but before filing the tax return; and,
- A general index of principal and background documents and a description of the recordkeeping system.

Tax audit procedure

Throughout the course of a tax audit, a taxpayer with cross-border intercompany transactions (which must be reported on Forms 5471, 5472, and 8865) should expect to undergo some sort of TP scrutiny.

Developed by the IRS, the “TP Audit Roadmap” (the “Roadmap”) is used by IRS TP specialists as a general guide through the TP audit process.

The Roadmap can be viewed at <http://www.irs.gov/pub/irs-utl/FinalTrfPrcRoadMap.pdf>

In the “Planning Phase,” the first stage of the audit process laid out in the Roadmap, the IRS will gather initial information, such as contemporaneous TP documentation. If such documentation exists, it must be supplied by the taxpayer within 30 days of request. In many cases, the existence of thorough, logical documentation that complies with IRC Section 1.6662-6(d) may eliminate the need for further examination.

In the event that the IRS chooses to proceed with a TP audit, the next step, the “Execution Phase,” will begin. The Execution Phase includes further fact finding and gathering by the IRS, and interviews and discussions will be held for the IRS to better understand the relevant facts and transactions. Follow-up information likely to be requested includes:

- Written copies of interview notes;
- Financial statements;
- Documents provided to advisors preparing memos;

- Third-party contracts and agreements;
- Intercompany agreements with support for terms;
- Copy of customers ordered by name;
- Financial forecasts;
- All marketing and sales activities; and,
- Major competitors.

Throughout the Execution Phase, the IRS will decide the position on the controlled transactions under audit. If the IRS decides to propose an adjustment, a draft "Notice of Proposed Adjustment" ("NOPA") will be provided for the taxpayer's review.

The "Resolution Phase," the final stage of the audit, will include a presentation of the IRS's findings to the taxpayer, during which the IRS will attempt to resolve any disagreements regarding the way facts are presented and the final NOPA will be issued. At this point, the taxpayer may agree or disagree with the findings in the NOPA, and resolution or appeals processes will begin.

Income adjustment, surcharges, and penalties

According to U.S. Treas. Reg. Section 1.482-1(e)(3), IRS TP specialists may adjust the financial results of a controlled taxpayer if they determine that a controlled transaction does not meet the arm's length standard. This adjustment may be any point within the IRS-determined arm's length range. However, the IRS will generally adjust the taxpayer's results to the median of that range.

In the event that a taxpayer does not have proper contemporaneous TP documentation and the IRS imposes a TP adjustment that increases U.S. taxable income, the IRS may also impose a penalty of 20 percent of the underpayment of tax if (i) the initial price charged was 200 percent greater or 50 percent less than the arm's length price; or (ii) the net adjustment exceeds the lesser of US\$5 million or 10 percent of gross receipts. If the initial price charged was (i) 400 percent greater or 25 percent less than the arm's length price; or (ii) the net adjustment exceeds the lesser of US\$20 million or 20 percent of gross receipts, the IRS may impose a penalty of 40 percent of the underpayment of tax.

Advance pricing agreements

Rev. Proc. 2006-9 permits taxpayers to apply for unilateral, bilateral, and multilateral APAs. The standard term for an APA is five years, though longer terms may be considered. The fee for filing an APA is \$50,000, and a routine renewal request is \$35,000. For smaller taxpayers (with a gross worldwide income of less than \$200 million, with transactions of less than \$50 million annually, or with intangible transactions of less than \$10 million annually), the filing fee may be reduced to \$22,500, for both the original application and subsequent renewals. To amend either an APA request or a completed APA, the fee is \$10,000. Timeline for obtaining an APA is typically 12 to 18 months.

Ex post measures to prevent double taxation

The U.S. has not signed onto the Multilateral Instrument, but U.S. taxpayers are generally in a good position to receive relief from double taxation, as the U.S. has approximately 60 income tax treaties with other nations.

In the event that a taxpayer is informed about adjustments to their taxes owed to the IRS or to a foreign government that result in double taxation, they may file a request for a MAP. For U.S. initiated adjustments, requests for assistance from competent authority may be made as soon as the NOPA is received. For foreign initiated adjustments, requests for assistance from the CA may be made when the taxpayer believes the request is warranted based on the actions of the TA proposing the adjustment.

Other non MAP options available to taxpayers include appeals processes, rolling back an APA to include all years under audit, or simultaneous appeals and competent authority processes.

Intercompany financing

The U.S. TP regulations relevant to loan and guarantee transactions do not set forth specific methods for evaluating the arm's length nature of the transfer prices, which creates flexibility to use unspecified methods to price financing transactions.

As a very general rule, all financial services TP revolves around CUPs, observable market prices, plus adjustments to render the prices more comparable to the controlled transactions. With regard to loans, for example, the "arm's length rate of interest" is a rate that would have been charged at the time the indebtedness arose in independent transactions with unrelated parties under similar circumstances, including credit worthiness of the borrower; principal amount of the loan; duration of the loan; security involved; and interest rates of comparable loans.

Arm's length interest rate

The IRS does not specify methods for determining the arm's length interest rate. *Treas. Reg. 1.482-2* defines an arm's length interest rate as "a rate of interest which was charged, at the time the indebtedness arose, in independent transactions with or between unrelated parties under similar circumstances."

Deductibility of interest

Under certain limitations, interest expenses are generally deductible.

Loan write off treatment

Generally, a loan written off is considered income to the borrower. However, exceptions may apply.

Safe harbour provisions/exemptions for SMEs

The IRS provides several options for SMEs to reduce the administrative burden, with regards to the topics below.

a. Safe haven interest rate

Under the “safe haven” provision of *Treas. Reg. Section 1.482-2(a)(2)(iii)*, the IRS will regard an intercompany interest rate located in between “100 percent of the applicable federal rate” and “130 percent of the applicable federal rate” as an “arm’s length rate.”

In order to apply for the safe haven interest rates, neither participant to the intercompany financing may be regularly engaged in the business of lending, and the lending transaction must be denominated in U.S. dollars.

The safe haven elective relieves taxpayers of the requirement to incorporate credit risk differentials into the loan pricing.

b. Treasury regulations section 1.482-9

The SCM is an elective method that allows the taxpayer to charge for services at-cost if the services are on the list of “covered services” provided in Rev. Proc. 2007-13, or if they have a median comparable markup of seven percent or less (“low-margin services”). As an additional requirement, the covered or low-margin services must not constitute significant contributions to key competitive advantages, core capabilities, or fundamental business risks.

c. Revenue procedure 2006 9:

A simplified APA procedure for SMEs is allowed to reduce burden and response time.

TP and PEs (AOA)

The US effectively adopts the AOA. *Article VII(2) of the 2016 U.S. Model Treaty* provides the base language for a TP based approach, stating: The profits that are attributable in each Contracting State to the PE... are the profits it might be expected to make, in particular in its dealings with other parts of the enterprise, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used and risks assumed by the enterprise through the PE and through the other parts of the enterprise.

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