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In this issue:

Australia’s new penalty laws for CbC reporting and an update on its implementation approach

Australia’s approach to country-by-country (CbC) reporting is characterized by the severity of its penalties for noncompliance, its divergence from the OECD Action 13 standard regarding the local file, and the fact that it places the obligation for compliance squarely with the local Australian taxpayer.

On 4 April 2017, the Australian government passed legislation to significantly increase late lodgement penalties for Australian taxpayers that are members of an accounting consolidated group with annual global income in the preceding period of AUD 1 billion or more (referred to as significant global entities, or SGEs), to potentially AUD 525,000 for each statement.

This change is crucial, given that Australia’s implementation of CbC reporting places primary responsibility for lodging the CbC report and the master file with the local taxpayer. Further, the Australian local file deviates significantly from the OECD standard, requires a significant amount of transactional information, and must be lodged in a particular XML format specified by the Australian Taxation Office (ATO).

Introduction

As part of the local implementation of the OECD’s *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 – 2015 Final Report*, the ATO has issued guidance on CbC reporting requirements effective for income years commencing on or after 1 January 2016. SGEs will be required to provide the ATO with a CbC report, a master file, and a local file within 12 months of the end of the applicable financial year in the specific format required by the ATO.

Existing Australian transfer pricing laws and associated transfer pricing documentation laws, which first came into effect for income years commencing 1 July 2013, still apply. Australia’s transfer pricing documentation laws and CbC reporting laws are mutually exclusive, and neither fully aligns with OECD guidance. The Australian local file for CbC reporting purposes is not consistent with the OECD-designed local file outlined in Annex II to Chapter V of the *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. Further, the Australian local file is not equivalent to Australian transfer pricing documentation requirements for penalty reduction purposes. The ATO’s adoption of the term “local file” has caused confusion, given that this term may be interchangeable with transfer pricing documentation in other countries.

Key Australian country-by-country and transfer pricing requirements

Overview: A high-level summary of the five transfer pricing-related documents and statements for upcoming income years is provided in the following table.

	Transfer pricing report	International Dealings Schedule	CbC Report	Master File	Australian Local File
Regime	Existing laws	Tax return	CbC reporting	CbC reporting	CbC reporting
Application	All taxpayers	Taxpayers with international related-party dealings (including loan balances) of AUD 2 million or more	SGEs	SGEs	SGEs
Mandatory	No, but required for penalty protection	Yes	Yes	Yes	Yes
Exemption available	No	No	Yes	Yes	Yes
Per OECD guidance	No	No	Yes	Yes	No
Filing requirement	No	Yes	Potentially	Yes	Yes

	Transfer pricing report	International Dealings Schedule	CbC Report	Master File	Australian Local File
Deadline (post-year-end)	6.5 months	6.5 months	12 months	12 months	12 months

Additional details of these statements are outlined below.

Existing transfer pricing compliance requirements: Transfer pricing documentation. There are very specific requirements that must be met in order for the transfer pricing documentation rules in Subdivision 284-E of the Taxation Administration Act 1953 to be satisfied. A taxpayer can be eligible for a reasonably arguable position (and therefore potential penalty reduction in the event of a transfer pricing adjustment) only if it has transfer pricing documentation prepared prior to lodgement of its income tax return. The ATO has indicated to Australian taxpayers that, on their own, preparation of an Australian local file (as described below), or preparation of an OECD-designed local file (that is, in accordance with BEPS Action 13 recommendations) will not meet the requirements of the transfer pricing documentation rules, given that the documentation is required to explain, among other things, the particular way in which Subdivision 815-B of the Income Tax Assessment Act 1997 (the transfer pricing laws) applies (or does not apply) to a taxpayer's international related-party dealings.

Section A of the international dealings schedule (IDS). All taxpayers with total international related-party dealings over AUD 2 million (including loan balances) are required to complete an IDS, which is a schedule to the corporate income tax return. The IDS provides a summary of the nature of a company's international related-party dealings, the jurisdictions of major counterparties, the level of transfer pricing documentation available for each dealing, and the main pricing method used for each dealing. The ATO uses the IDS as a risk assessment tool to identify taxpayers with either perceived high-risk or material international related-party dealings.

Country-by-country reporting requirements: CbC report. SGEs have the primary obligation to obtain the CbC report and file it with the ATO, unless it is filed in a country that is signatory to the Multilateral Competent Authority Agreement on Automatic Exchange of CbC Reports. Exemptions may be granted in limited circumstances.

Master file: An SGE must obtain a copy of the master file in English from its parent entity and file it with the ATO. The required contents of the master file are consistent with those outlined in Annex I to Chapter V of the OECD transfer pricing guidelines.

Australian local file: SGEs must prepare and lodge an Australian local file with the ATO. The Australian local file is an electronic file that must be lodged as an XML file in a specific format outlined by the ATO. The contents and the format of the Australian local file are not like those of a traditional transfer pricing report (for example, neither a functional analysis nor an economic analysis is required) and do not align with that outlined by the OECD in Annex II to Chapter V of the transfer pricing guidelines. The Australian local file should instead be seen as a far more detailed version of the IDS in that it will act as a more powerful risk assessment tool for the ATO to better identify risk review or audit candidates. The Australian local file consists of the following:

- **Short form local file:** A document that includes information relating to the three bullet points outlined under the "local entity" heading of Annex II to Chapter V of the transfer pricing guidelines. While all taxpayers will need to prepare a short form local file, those that do not exceed certain materiality thresholds and meet other criteria will not have to prepare or provide the ATO with any of the other information below.
- **Part A of the local file:** SGEs are required to provide transactional information on all international related-party dealings, including counterparties, type of dealing, amount, method used to price the dealing, level of documentation maintained to support the arm's length nature of the dealing, and the foreign exchange gain or loss incurred in relation to each dealing. The format of Part A of the local file is best described as being analogous to a highly granular, transaction-based version of the CbC report, with 26 disclosures required for every dealing. Given that Part A of the local file is in substance a more detailed version of the IDS, the ATO has indicated it will provide SGEs with an exemption from having to lodge the IDS should they voluntarily file Part A of the local file at the same time as they lodge their tax return.
- **Part B of the local file:** As an extension to Part A of the local file, SGEs are required to provide a further 18 disclosures for all "material" international related-party dealings in relation to the nature of agreements relating to those dealings.

- **Other attachments:** The SGE must attach copies of several files as part of its local file lodgement, including the master file, all intercompany agreements for "material" international related-party dealings, copies of foreign advance pricing agreements (APAs) that relate to Australian dealings and financial statements (noting that SGEs may need to prepare these as general purpose financial statements for income years commencing on or after 1 July 2016).

Exemptions and replacement reporting periods: An SGE can apply to the ATO for an exemption from filing one or more of the CbC documents. For example, it can request an exemption from filing the CbC report for the first year of reporting on the grounds that the parent company jurisdiction is implementing CbC reporting requirements at a later date than Australia. If an SGE has a different income year-end than its parent, it will need to make a written application to the ATO requesting the use of a 12-month period aligned with the income year of an SGE's parent entity (replacement reporting period) for the CbC report and master file.

New late lodgement penalties

Lodging required documents with the ATO is now particularly important, given that a new penalty regime was recently introduced for SGEs with effect from 1 July 2017. SGEs will be subject to a penalty of at least AUD 105,000 in relation to the late lodgement of any document, rising to a maximum of AUD 525,000 in instances when these become overdue by more than 16 weeks.

Each of the CbC reporting statements (master file, local file, and CbC report) constitutes a separate statement subject to this penalty regime, which also extends to an SGE's failure to lodge any other tax document (for instance, an income tax return) with the ATO on time or in the approved form. Lodging numerous tax documents late therefore could result in material (and nondeductible) penalty amounts being payable.

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IRS files notice of appeal in *Medtronic* case

The Internal Revenue Service on 21 April filed a notice of appeal in *Medtronic Inc. v. Commissioner*, T.C. Memo 2016-112, to the Eighth Circuit Court of Appeals (Docket No. 006944-11). At issue is the appropriate royalty rate between Medtronic US and its Puerto Rican subsidiary, Medtronic Puerto Rico Operations Co. (MPROC) (the licensed manufacturer issue). The Eighth Circuit will decide whether the IRS's use of the aggregate comparable profits method (CPM) was appropriate to determine the royalty rate, or whether the comparable uncontrolled transaction (CUT) method, as adjusted to take into account differences between the controlled and uncontrolled transactions, is more reliable.

Also at issue are: (i) royalty payments made by Medtronic Europe, S.a.r.L. (Medtronic Europe) to Medtronic US for use in the manufacture of medical devices that were sold to another US affiliate named Medtronic USA, Inc. (Med USA) pursuant to a supply agreement among Medtronic US, MPROC, and Medtronic Europe (the Swiss supply agreement issue); and (ii) whether Medtronic US, Med Rel, Inc., or Medtronic Puerto Rico, Inc.,[1] transferred intangible property compensable under Internal Revenue Code section 367(d) to MPROC when Medtronic US restructured its Puerto Rican operations in 2002 (the section 367(d) issue).

[1] Medtronic Puerto Rico, Inc. was the predecessor of MPROC.

Tax Court decision

The US Tax Court on 9 June 2016 sided with the taxpayer on most of its positions. For a detailed summary of the Tax Court decision, see Global TP Alert 2016-20, June 14, 2016. A brief summary of the salient issues is provided below.
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-020-14-june-2016.pdf

Licensed manufacturer issue: The licensed manufacturer issue involved two different types of agreements – one for a trademark license and another for devices and leads licenses. The court found that Medtronic US's proposed CUT method for the trademark license met the requirements of section 482 and therefore accepted that royalty as proposed.

With respect to the devices and leads licenses, the court disagreed with both the IRS's aggregate CPM position and with Medtronic US's proposed CUT method. Nevertheless, the court's disagreement with Medtronic US's proposed position was primarily on the basis that the taxpayer's proposed CUT method did not make all the necessary comparability adjustments.

Under Medtronic US's approach, a 7 percent royalty was adjusted to a 29 percent royalty for the devices license due to certain factors such as exclusivity and know-how. The Tax Court found that, despite deficiencies in the taxpayer's analysis, this approach could be used as a starting point. The court then made additional comparability adjustments to increase the royalty for the devices license from 29 percent to 44 percent.

In contrast, the court found that an appropriate royalty for the leads was, as Medtronic US argued, half of the rate for the licenses. The court held, therefore, that the leads royalty should be 22 percent.

The court's own analysis on these licenses ended up with royalty rates similar to the IRS's position and to rates in a memorandum of understanding (MOU) that the taxpayer and the IRS had entered into covering earlier years. The court stressed, however, that the similarity between its conclusion and the MOU was purely coincidental.

Swiss supply agreement issue and section 367(d) issue: The court applied the same analysis to the Swiss supply agreement issue as to the devices licenses, and held that the royalty for the Swiss supply agreement issue should be 44 percent as well.

Finally, the court examined the section 367(d) issue, but rejected the IRS's assertions. The court concluded that the IRS did not identify what intangibles, as defined under section 936(h)(3)(B), had been transferred, or explain the specific value of any intangibles that should be covered by section 367(d). In addition, the court concluded that there was no section 367(d) transfer, because the intangibles used by MPROC were the subject of the devices and leads licenses.

Procedural posture on appeal

The IRS is now appealing the US Tax Court decision, which was a memorandum opinion issued by a single judge. Such an opinion is issued when the Tax Court considers that a case does not involve a novel legal issue and when the law is settled or factually driven.

On appeal, the Eighth Circuit will consider all the legal arguments, and it will not be bound by any of the Tax Court's legal determinations in the case.

Observations

The IRS's choice to appeal this decision is notable. In some ways, the *Medtronic* case could be interpreted as an affirmation of the court's long-standing disagreement with the IRS in cases like *Bausch & Lomb, Inc. v. Commissioner*, 92 T.C. 525, 582 (1989), *aff'd*, 933 F.2d 1084 (2d Cir. 1991), where the IRS contended that an offshore manufacturing company should be analyzed simply as a contract manufacturer. In *Medtronic*, the Tax Court, continuing its demonstrated preference for CUTs, even if inexact, rejected the IRS's aggregate CPM analysis. In doing so, the court focused for the most part on the strength of the taxpayer's functional analysis, which highlighted the importance of the licensee's contributions to maintaining product quality and assuming quality-related risks.

If the Eighth Circuit upholds the Tax Court's opinion, it would provide further support for this interpretation.

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OECD updates guidance on local filing requirements of country-by-country reports

The Organisation for Economic Co-operation and Development (OECD), as a continuation of its base erosion and profit shifting (BEPS) initiative, on 4 May updated its guidance for local filing requirements of country-by-country (CbC) reports.

Local (or secondary) filing refers to when a jurisdiction requires the filing of a CbC report by a resident constituent entity of a multinational enterprise (MNE) that is not the ultimate parent entity (UPE) of its group. For example, if an MNE is headquartered in Country X but has a subsidiary in Country Y, and Country Y has a local filing requirement, then the subsidiary in Country Y may have to file the CbC report itself.

The OECD's new guidance provides rules on when local filing should apply and what conditions must be satisfied when it is required. An overview of the new guidance is provided below. Overall, the new guidance should prove to be a welcome development, especially for MNEs with UPEs in the United States.

Local filing guidance in general

The OECD has made clear that local filing does not form part of the Action 13 minimum standard, and that it should be required only in "exceptional circumstances." There is no requirement for a jurisdiction to mandate local filing.

When local filing rules do apply, the OECD has now advised countries that such rules should be limited to three specific circumstances, as described in the OECD model legislation for the implementation of CbC:

- **No CbC obligation by residence jurisdiction:** The UPE of an MNE group is not obligated to file a CbC report in its residence jurisdiction;[2]
- **Exchange available between the jurisdictions but no qualifying agreement in place yet:** The UPE's residence jurisdiction has a current international agreement (*i.e.*, a multilateral or bilateral tax convention or a tax information exchange agreement providing for the automatic exchange of tax information) with the constituent entity's residence jurisdiction, but there is no qualifying competent authority agreement in place between the two jurisdictions *by the end of 12 months* following the end of the fiscal reporting year of the MNE group; or
- **Systematic failure:** There has been a systemic failure to exchange CbC reports by the UPE's residence jurisdiction, which has been notified to the constituent entity by the tax authority in its residence jurisdiction.

Even if one of these three conditions has been met, the OECD has recommended placing the following further limitations on local filing requirements, stating that local filing should still not be permitted when: (i) a CbC report will

[2] The OECD previously issued guidance in June 2016 that interpreted this language as not applying to jurisdictions that provide for voluntary "parent surrogate" filings if certain conditions are satisfied. For prior coverage, see Global Transfer Pricing Alert 16-023.
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-023-1-july-2016.pdf

be filed by a surrogate parent entity (SPE) of the MNE group for the relevant reporting fiscal period (subject to conditions); or (ii) the residence jurisdiction of the constituent entity does not meet conditions in the minimum standard concerning consistency, confidentiality, and the appropriate use of CbC reports.

Clarification of the second of the three circumstances listed above is of particular relevance for US MNEs. In essence, it advises that local filing should not be required in a jurisdiction with which: (i) the United States does not have a bilateral tax treaty or tax information exchange agreement (TIEA) in place that provides for the automatic exchange of information; or (ii) for jurisdictions within the US tax treaty and TIEA network, the United States has not entered into a CbC competent authority agreement (CAA) between now and 12 months after the end of MNE group's fiscal year. For US MNE groups on a calendar year, that will give the United States until December 31, 2017, to enter into a CbC CAA before any local filing rules will be required. Further, under the second additional limitation, if the reason the US has not entered into a CAA with a jurisdiction is because that jurisdiction does not meet the minimum standard concerning consistency, confidentiality, and the appropriate use of CbC reports, then it should not impose local filing.

According to the OECD, the purpose of this new guidance is to provide additional flexibility for MNE groups to file their CbC reports and for governments to put CbC CAAs in place. The new OECD guidance is intended to ensure that resident constituent entities in MNE groups where a UPE or SPE will file a CbC report by December 31, 2017, are not affected by local filing obligations.

Local filing in Brazil

In Brazil, the CbC reporting requirement applies starting in 2016, and resident UPEs are required to file a CbC report with their corporate income tax return for the year, which are generally due on July 31, 2017. This July 31 filing deadline applies not only to Brazil UPEs but also to Brazil constituent entities that potentially have to meet Brazil's local filing requirements, unless they provide notification that a UPE or SPE resident outside of Brazil will serve as the reporting entity. [For prior coverage, see Global Transfer Pricing Alert 17-013]
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-17-013-19-april-2017.pdf

The OECD's new guidance recommends that added flexibility be provided for MNE groups with constituent entities in Brazil. Although not an OECD member, Brazil is a BEPS-participating country and therefore this guidance presumably was issued with the consent of Brazil. Pursuant to the new guidance, a Brazil constituent entity of a foreign MNE group that wishes to avoid local filing in Brazil must submit a CbC notification by July 31, 2017. That notification must inform the Brazilian tax authorities of the identity and tax residence of the group's reporting entity. The new guidance clarifies that such information is based on an initial assessment of whether the conditions for local filing are expected to be met as of December 31, 2017. Where this notification subsequently proves to be incorrect, however, a resident constituent entity in Brazil may submit an amended notification by December 31, 2017 (or comply with local filing).

This new guidance will help MNEs who comply with the notification requirements in good faith but who later discover that there was an error in their initial assessment as to which entity will be the reporting entity for the MNE group. If such an error does occur, then the MNE group would be permitted to file an amended notification by the end of the 2017 calendar year.

Local filing in China

CbC reporting requirements apply in China, which is also a BEPS-participating country, starting in 2016. China UPEs on a calendar fiscal year are required to file a CbC report with China by May 31, 2017. Chinese constituent entities that are not UPEs are not automatically required to file CbC reports in China, but may be required by local tax offices to provide the CbC report in the course of a transfer pricing audit, when the conditions for local filing under the minimum standard are met.

According to the OECD update, China has issued guidance to its local tax offices to clarify that an extension of the local filing deadline will be granted when a China constituent entity provides written evidence that a CbC report for such fiscal period will be filed by the group's UPE or SPE in another jurisdiction with a later filing deadline. Most jurisdictions require a resident UPE with a 2016 calendar fiscal year to file on or before December 31, 2017, for example. Local filing will not be required, however, when the UPE or SPE of a group is required to file a CbC report in accordance with the minimum standard, and the conditions for local filing in the minimum standard are not met.

Again, the OECD's new guidance provides more flexibility for MNE groups that have constituent entities in China, either by extending the deadline for local filing (upon request) or by recommending situations in which local filing should not be required.

Conclusion

As noted above, the OECD's new guidance should prove to be a welcome development for US-parented MNEs. This guidance will provide more time for the IRS to enter into CbC CAAs, and it will ease the burden on MNEs with constituent entities in Brazil and China, and in jurisdictions that have not met the conditions in the minimum standard concerning consistency, confidentiality, and the appropriate use of CbC reports. All of this should provide more flexibility for countries and companies to comply with the Action 13 CbC reporting requirements, particularly for fiscal years beginning on or after January 1, 2016.

However, OECD guidance only indicates a consensus view, and is not actual law. Therefore, all OECD and BEPS-participating countries should abide by this new guidance, but actual adherence to it may vary.

For the full text of the new guidance, see "Country-by-Country Reporting: Update on exchange relationships and implementation."
URL: http://www.oecd.org/tax/beps/country-by-country-reporting-update-on-exchange-relationships-and-implementation.htm

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Mexico publishes final master file, local file, and CbC report rules

Mexico's Tax Administration Service (SAT) on 12 April published on its website the final compliance rules regulating the contents and filing of the master file, local file, and country-by-country (CbC) report, as well as a report on the public consultation conducted by the Taxpayer's Ombudsman Office (*Procuraduría de la Defensa del Contribuyente* or PRODECON), concluding a process that began in October 2016. These rules are considered official under the terms of Rule 1.8 of the Fiscal Miscellaneous Resolution.

Article 76-A of the Mexican Income Tax Law (MITL) requires that for fiscal year 2016, companies that enter into transactions with related parties (in Mexico or abroad) and receive revenue[3] equivalent to or greater than MXN 686,252,580 (approximately USD 37 million) must file a master file and a local file. In addition, Mexican multinational enterprise (MNE) groups that receive revenue equal to or higher than MXN 12,000 million (approximately USD 648 million) also must file a CbC report.

The published rules simplify the fulfillment of the filing obligations by concluding that taxpayers are not obligated to provide certain documentation, and in some specific cases by allowing the filing of the information in English or Spanish, rather than just Spanish under the previous rules.

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[3]The direct translation from Spanish is "taxable income," but the term refers to revenue determined under Mexico's Income Tax Law.

Master file

Under the final rules, if a master file is completed outside of Mexico in accordance with the guidance in the Organisation for Economic Cooperation and Development (OECD)'s final report on Action 13 of the base erosion and profit shifting (BEPS) project, it will be accepted in Mexico in English or Spanish.

The final rules regarding the Mexican master file also provide as follows:

- The SAT has accepted the guidance in the Action 13 final report regarding the inclusion in the master file of information on the taxpayer's five principal products or services, as well as products or services representing 5 percent of the MNE's total revenues. Prior rules required taxpayers to provide data on their main products, but did not specify how many products had to be included.
- The information required in the master file may be presented in foreign currencies, and if the taxpayer so wishes, by line of business.
- Definitions for the following terms were included in the final rules:
    - Business restructuring;
    - Multinational business group;
    - Intangible assets; and
    - Transfer pricing policies.

For filing the master file, one entity can file a single master file on behalf of all Mexican taxpayers that meet the master file requirement. The names and taxpayer ID numbers of the companies resident in Mexico that are part of the group and are obligated to file a master file should be listed in the filing.

Local file

The local file rules require that the Mexican taxpayer provide the following information:

- A detailed description of the taxpayer's organizational structure, strategic and business activities, intercompany transactions, and the transfer pricing policy for each intercompany transaction. Information on intercompany transactions must be grouped by the type of transaction.
- A description of the MNE group's supply chain, indicating the taxpayer's participation and location; whether the activities at each point of the supply chain are routine or value added; and the transfer pricing policies used to allocate profits to the portion of the supply chain to which the Mexican taxpayer belongs.
- A list of the taxpayer's principal competitors.
- A description of the MNE group's strategy for the development, enhancement, maintenance, protection, and exploitation of intangibles (DEMPE activities).
- A copy of the Mexican taxpayer's contracts with related parties (may be submitted in English or Spanish.)
- A functional analysis for each individual intercompany transaction.
- A detailed description of and justification for the transfer pricing method selected.
- A description of the search process used to identify potentially comparable companies or transactions, the profit level indicator selected, and the application of comparability adjustments.
- For each intercompany transaction, a justification of the selection of the tested party and the reasons for rejection of the counterparty.
- A business description of comparables (may be submitted in English or Spanish).
- A detailed explanation and justification for performing a multiyear analysis.
- Financial information (segmented, if that's the case) of the tested party (taxpayer or related party) and the comparable companies, including arithmetical calculation of profits.
- Certain financial and tax information of foreign related parties (current assets, fixed assets, sales, costs, operating expenses, net income, taxable base, and tax payments, specifying which currency was used).
- A list of any advance pricing agreements and other tax rulings related to the transactions entered into by the taxpayer with related parties during the fiscal year to which the Mexican tax authority is not a party. Copies of these agreements the Mexican taxpayer has in its possession must also be submitted with the local file.

The final rules clarify that the information contained in the local file is evidence of compliance with the arm's length principle in accordance with Articles 179 and 180 of the MITL.

The local file is a separate document from the traditional transfer pricing documentation report that large multinational companies typically prepare by 30 June. Under the final rules, the SAT does not require the submission of the transfer pricing documentation study together with the local file. However, taxpayers should continue to prepare their transfer pricing documentation report contemporaneously in order to receive penalty protection. The regulations governing the 30 June transfer pricing documentation report have not changed. For a more detailed discussion, see the "Transfer Pricing Information Report" section below.

Country-by-country report

Under the final rules, Mexican multinational business groups do not have to file several CbC reports; rather, only one report is filed per Mexican ultimate parent entity.

The final rules also provide that the CbC report may be filed using foreign currencies.

Deadlines

The deadline for submitting the local file is 12 months after the end of the fiscal year.

For MNE groups with a calendar year end, the deadline for submitting the CbC report for Mexican MNEs and the master file is December of the following year. For foreign MNEs whose fiscal year end does not follow the calendar year, the final rules made the following clarifications regarding the deadline to submit the master file or the CbC report under the secondary filing mechanism:

- When the fiscal year ends in June, July, August, September, October, November, or December, the deadline is 31 December of the year immediately following the declared fiscal year;
- When the fiscal year ends in January, the deadline is 31 January of the year immediately following the declared fiscal year;
- When the fiscal year ends in February, the deadline is the last day of February of the year immediately following the declared fiscal year;
- When the fiscal year ends in March, the deadline is 31 March of the year immediately following the declared fiscal year;
- When the fiscal year ends in April, the deadline is 30 April of the year immediately following the declared fiscal year; and
- When the fiscal year ends in May, the deadline is 31 May of the year immediately following the declared fiscal year.

Comments

The draft rules published by the SAT through PRODECON in October 2016 required information that exceeded what Action 13 of the BEPS Action Plan contemplated. After a six-month process that involved technical analysis by PRODECON and practitioners, as well as technical opinions from the public in general and discussions with the SAT, the new master file and CbC report requirements are in line with the principles in BEPS Action 13.

As to the local file, the final rules include some items that differ from the BEPS Action 13 format:

- Companies that enter into transactions only with domestic related parties but pass the taxable income threshold must also file a master file and a local file.
- The Mexican local file requires the testing of all transactions with domestic related parties, whereas the OECD's guidance under Action 13 relates only to transactions with related parties resident abroad.
- The local file requires the disclosure of whether activities in each part of the supply chain are routine or value added, and the allocation of profits within the supply chain when relevant to the Mexican taxpayer.
- In the case of intangibles, the local file may require additional DEMPE activities of the MNE in comparison to what is already required under an OECD master file.
- Functional and economic analyses must be prepared on a transaction-by-transaction basis.
- Certain financial and tax data must be disclosed. Nevertheless, the previous requirement of filing full financial statements and tax returns of foreign related parties was eliminated.
- The preparation date, as well as the tax ID number of the preparer of the transfer pricing study (and that of the transfer pricing advisor, if different) must be included.

- The local file requires confirmation that transactions with related parties were entered into at arm's length values and whether transfer pricing adjustments were applied to comply with the arm's length principle.
- The local file must be prepared in Spanish.

Taxpayers that have entered into an APA covering one or several intercompany transactions and maquiladoras that opted for an APA are not required to submit the local file.

Now that the final rules have been published, the tax authorities must release the electronic platform for the filing of the master file, local file, and CbC report. Time is of the essence in this regard, given the 31 December 2017 filing deadline.

Transfer pricing information returns

The general rule is that Mexican taxpayers must submit a transfer pricing informative return (Appendix 9, "Operations with Foreign Related Parties") with their annual tax return, which is due 31 March. However, most international taxpayers will qualify for a three-month extension. Companies submitting a Dictamen Fiscal, filed by the auditor, or DISIF, filed by the taxpayer, can file Appendix 9 on 30 June, three months after the general due date of the pertinent year.

As a practical matter, most taxpayers will need to have prepared Mexican transfer pricing documentation by the time the Dictamen Fiscal or DISIF and Appendix 9 need to be submitted, because Appendix 9 asks taxpayers to disclose information contained in an economic analysis, such as the interquartile range and results, the number of comparables used in the economic analysis, and the SIC code selected. Furthermore, taxpayers or the external auditor need to disclose in the Dictamen Fiscal or DISIF whether the entity has a transfer pricing study, along with other information such as method applied in the transfer pricing study.

Transfer pricing documentation

Taxpayers engaged in business activities whose revenue in the preceding fiscal year exceeded MXN 13 million (approximately USD 650,000) or taxpayers whose revenue related to the rendering of professional services in the preceding fiscal year exceeded MXN 3 million (approximately USD 150,000) must prepare TP documentation to receive partial relief from TP penalties in the event of an adjustment.

In practice, documentation is required by the later of the tax return due date or the date of submission of the Dictamen Fiscal and DISIF. In most cases, an OECD local file report would not substantially comply with Mexico's TP documentation requirements, because Mexican rules require analyzing transactions entered into with domestic and foreign related parties on a transaction-by-transaction basis. In addition, in selecting the best method, taxpayers are required to analyze the methods in the traditional hierarchy, that is, CUP, resale price, cost plus, etc. Moreover, the Dictamen Fiscal and DISIF require information regarding the Mexican Tax ID number of the preparer of the transfer pricing documentation and the transfer pricing advisor (if different).

Mexico's official language is Spanish, and in accordance with current legislation, all information considered part of the accounting records (including transfer pricing documentation) must be prepared in Spanish. If the report is not prepared contemporaneously in Spanish, there is a risk the SAT may conclude that contemporaneous TP documentation is nonexistent.

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Australia issues draft risk-assessment framework for related-party financing

The Australian Taxation Office on 16 May released the draft Practical Compliance Guide PCG 2017/D4 (the PCG), which outlines the ATO's risk assessment framework for related-party financing arrangements.
URL:
https://www.ato.gov.au/law/viehttps:/www.ato.gov.au/law/view/document?DocID=COG/PCG20174/NAT/ATO/00001w/document?DocID=COG/PCG20174/NAT/ATO/00001

Although this PCG has been anticipated for some time, it seems that the release of the framework was timed to follow the decision in favor of the ATO in the recent Full Federal Court case involving Chevron. The PCG has been issued in the context that inbound loans to Australian taxpayers exceed AUD 400 billion, and the ATO is concerned that even small shifts in pricing can have a significant impact on the tax system.
URL: http://www.austlii.edu.au/au/cases/cth/FCAFC/2017/62.html

The PCG sets out how the ATO will assess compliance risk attaching to cross-border related-party financing arrangements, and invites companies to self-assess their compliance risk. If necessary, companies are welcome, and in fact encouraged, to discuss the issue with the ATO to mitigate any actual or perceived risks. While it is not mandatory for most taxpayers to use the framework, the ATO is strongly encouraging taxpayers to use the tool as part of their wider tax governance processes, and will ask companies required to complete the Reportable Tax Positions form to provide information regarding their risk assessment conclusions.

The PCG makes it clear that the risk-rating exercise is a separate exercise than determining whether a transfer pricing benefit has been obtained. The PCG does not provide technical advice or interpretation and does not constitute a safe harbor.

The framework is complex, and uses an approach similar to that in the recent PCG 2017/1, which deals with a risk assessment framework for "marketing hubs." It involves a series of risk "zones" that range from white to red, and it applies to both outbound and inbound loans. The framework uses a number of factors and allocates a score to the answer for each factor (for each loan). The cumulative score will determine the risk zone that applies to each loan.

The ATO state that when taxpayers have arrangements in higher risk zones, the expectation will be higher that they have high-quality transfer pricing documentation in place to support the arm's length nature of the arrangements.

The PCG will be effective 1 July 2017, and will apply to existing and newly created financing arrangements, structures, and functions.

In detail

The PCG has two parts: a statement of general principles and a schedule that addresses the transfer pricing risk factors associated with related-party debt funding. The PCG does not address other risk factors associated with financing arrangements, such as the operation of the debt/equity rules, thin capitalization rules, interest withholding tax provisions, or Part IVA, but those factors may be subject to separate risk analyses that could be included in additional schedules to be added to the PCG in the future.

The risk assessment methodology in PCG 2017/D4 is based on a cumulative scoring system, based on both qualitative and quantitative factors. Importantly, the framework is applied to each related-party financing arrangement of the Australian taxpayer.

The factors that should be assessed for inbound loans are:

- The interest rate of the loan relative to the cost of "referrable debt," effectively comparing the interest rate with the cost of global debt, traceable third-party debt, or relevant third-party debt of the taxpayer (*e.g.*, by how many basis points the interest rate exceeds the cost of referrable debt debt);
- The taxpayer's leverage ratio: whether it is consistent with the global consolidated leverage, and if not, whether it's less than or more than 60 percent;
- Interest coverage ratio relative to global ratio;
- The presence of appropriate collateral (security, guarantee, or covenants);
- The presence of subordinated or mezzanine debt;

- Is the currency of debt different from the operating currency;
- Is the arrangement covered by a taxpayer alert;
- The headline tax rate of the lender entity's jurisdiction;
- The presence of exotic features in the loan, such as payment in kind, or convertibility; and
- Whether one or more entities is a hybrid entity.

For outbound arrangements, the factors that should be assessed are:

- The loan's interest rate relative to the cost of referrable debt;
- The currency of debt (that is, is it different from the operating currency?);
- Whether the arrangement is covered by a taxpayer alert;
- Whether one or more entities is a hybrid entity; and
- The sovereign risk of the borrower entity (from AAA to CCC).

Each response to the above factors, for each loan, is then allocated a point score (0, 1, 3, 10, or 15) and then a total point score is derived for each loan.

Importantly, the draft PCG states that the above-mentioned indicators and their relative weight have been developed based on the ATO's expectation that, in most cases, the cost of related-party financing should align with the financing costs that could be achieved by the ultimate parent company (on an arm's length basis).

The allocation to a risk zone for each loan is based on the cumulative score as follows:

Zone	Risk rating	Score
Green	Low	0-4
Blue	Low to Moderate	5-10
Yellow	Moderate	11-18
Amber	High	19-24
Red	Very High	25 or more

The overall risk zone for a taxpayer will be that of the loan with the highest risk rating.

In terms of ATO activity in relation to each of the zones, the PCG outlines what taxpayers can expect:

Zone	ATO compliance response
White	Arrangements already reviewed by the ATO (for example, APAs or settlements) – no further action
Green	Limited compliance activity. ATO may look to confirm the taxpayer's risk assessment
Blue	ATO will actively monitor the loan arrangements
Yellow	ATO will work with the taxpayer to understand and resolve areas of difference
Amber	An ATO review is likely to commence as a matter of priority
Red	An ATO review or audit is likely to commence as a matter of priority

Impact

The PCG is a complex risk assessment tool and requires a careful analysis of each of the factors identified by the ATO. Moreover, the asymmetry in approaches between inbound and outbound loans could mean that any uniform existing global policy framework may be assigned different risk ratings (and documentation requirements) depending on which loan it is applied to.

Interestingly, the draft PCG does not include the size of the financing arrangement as a risk indicator, which will likely be a point of feedback to the ATO during the consultation period.

Some of the ATO's calibrations of risks will surprise many. For example:

- A margin 2 percent over the cost of referrable debt will by itself attract a risk score of 15 points.
- An interest coverage ratio of less than 3.3x will by itself attract a risk score of 10 points; to obtain a lower risk score, interest coverage must be between 3.3x to 9.9x. In our experience, this is well above sustainable interest coverage ratios in many industries and observed bank covenant levels.

The ATO acknowledges that simply being in a higher risk zone does not mean that an arrangement is inherently non-arm's length. Furthermore, it indicates that the expectations regarding the level and quality of transfer pricing documentation and analysis required to substantiate the rate will increase according to the risk rating, as noted above.

We note that the recent Chevron decisions considered a number of the issues that are considered risk factors, including currency, leverage, and collateral.

Senior ATO leaders have described intragroup financing as the "number one risk" it is focused on with regard to multinational taxation, and this risk assessment framework is a key element of the ATO's strategy. The ATO hopes that taxpayers will use this framework to consider their risk profile and to engage with the ATO prospectively, with a view to managing their risk profile.

Voluntary disclosures

The Commissioner of Taxation recognizes that taxpayers may wish to modify their related-party financing arrangements to come within the low-risk green zone. For a period of 18 months after the PCG is finalized, the ATO is willing to consider remission of penalties and interest for prior years when taxpayers adjust the pricing or level of debt to come within the low-risk green zone.

Recommended actions

The release of this PCG signals a significant uplift of ATO focus and activity in the area of cross-border financing. We recommend that taxpayers review their arrangements against the ATO risk assessment framework. Based on that assessment, it may be appropriate to review the financing terms, transfer pricing or legal agreement documentation, and in some cases potentially approach the ATO to obtain certainty.

The impact of the recent Chevron decision, the broader reforms to Australia's transfer pricing rules, and the recent introduction of the diverted profits tax means that taxpayers must be able to demonstrate the commercial basis for their intercompany financing arrangements, and adopt a wide global perspective in approaching these issues.

There is a consultation period on this draft PCG, and comments are due by 30 June 2017.

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Global Tax Reset: Transfer Pricing Documentation Summary

Deloitte's Global Transfer Pricing practice has prepared the Global Tax Reset – Transfer Pricing Documentation Summary, which compiles essential country-by-country (CbC) reporting and documentation information (including master file and local file information when applicable) for 56 jurisdictions around the world. The TP Documentation Summary has been reviewed and updated as of 26 May 2017.
URL: https://www2.deloitte.com/global/en/pages/tax/articles/global-tax-reset-transfer-pricing-documentation-summary.html?id=us:2em:3na:als:awa:tax:061217

The TP Documentation Summary is intended to be a quick reference guide, and is not an exhaustive compendium of all relevant details regarding CbC reporting and documentation rules in the 56 jurisdictions. For additional information, please contact a Deloitte Transfer Pricing professional.

The TP Documentation Summary will be updated as additional information becomes available – please check back for the latest update.

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Portugal extends deadline for filing CbC notification

Portugal's secretary of state for finance on 30 May released a Ministerial Order extending the deadline for filing the first notification requirement under Portugal's country-by-country (CbC) reporting rules.
URL: http://info.portaldasfinancas.gov.pt/NR/rdonlyres/50D8CE1A-C59C-489F-BF1A-DA6BBF0FED49/0/Despacho_SEAF_170_2017_XXI.pdf

For tax year 2016, the deadline to inform the Portuguese tax authorities of which entity will submit the CbC report and of its country of tax residence has been extended to 31 October 2017.

Under Portugal's CbC reporting rules, the deadline to notify the Portuguese tax authorities of which group entity will be the CbC reporting entity was originally the last day of the reporting period. However, for FY2016, a Ministerial Order dated December 12, 2016, extended this deadline to the last day of May 2017. That deadline has now been extended again.

Although the current legislation does not explicitly state that an electronic form will be made available to fulfil the notification requirement, the tax authorities are currently developing such a form. The legislation does state that taxpayers must communicate electronically to the PTA which group entity will be the CbC reporting entity before the deadline.

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Spain publishes draft order approving new form for reporting related-party and tax haven transactions

Spain's Tax Agency has published a draft order that would approve a new form – Form 232 – for reporting related-party transactions and transactions and situations that involve countries and territories deemed to be tax havens.

Because the order is still in draft form, it may be modified before final approval.

The preamble to the draft order indicates the tax authorities' intent to transfer the information on related-party transactions traditionally included in the income tax return (Form 200) to this new form.

The preamble also states that, to ensure the effective reduction of tax compliance burdens, the deadline for filing Form 232 has been set generally in May, so that it does not coincide with the deadline for filing income tax returns. In the case of returns for tax periods commencing in 2016, the filing period would run from 1 November to 30 November 2017. For subsequent years, the filing period would run from 1 May to 30 May.

It is still compulsory under Spanish rules to report all controlled transactions with the same related party, regardless of their individual amounts, if the total amount of the transactions exceeds EUR 250,000. In addition, the same type of individual transactions entered into in a given tax period with the same individual or related entity using the same valuation method and in an amount exceeding EUR 100,000 at arm's length value, also must be reported.

A new development to highlight is that for tax periods commencing in 2016 and onwards, two special rules regarding information traditionally included in Form 200 have been proposed:

- The first rule states that, even if the total amount of related-party transactions does not exceed the threshold mentioned above, taxpayers would still be required to report any transactions of the same type and using the same valuation method if the total amount of the transactions taken as a whole exceeds 50 percent of the entity's revenue.
- Under the second rule, certain "specific transactions" (transactions excluded from the simplified content of the documentation referred to in Article 18.3 of the Spanish Income Tax Law and Article 16.5 of the Spanish Income Tax Regulations) would have to be reported if the combined amount of each transaction type exceeds EUR 100,000. For this purpose, it is not necessary for the same valuation method to be used. Under this rule, each transaction type that exceeds the combined limit must be reported.

The text of the draft order and Form 232 are found on the website of the Spanish Ministry of Finance and Public Administration.
URL: http://www.minhafp.gob.es/Documentacion/Publico/NormativaDoctrina/Proyectos/Proyecto%20OM%20232.pdf
URL: http://www.minhafp.gob.es/Documentacion/Publico/NormativaDoctrina/Proyectos/Modelo%20232.pdf

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ECOFIN agrees on new directive on tax dispute resolution mechanisms

The European Council of Finance Ministers (ECOFIN) on 23 May agreed to the terms of a proposed new council directive on tax dispute resolution mechanisms in the European Union. The directive aims to improve existing mechanisms for resolving tax disputes between EU member states arising from the interpretation of double tax agreements by improving access to and the effectiveness of mutual agreement procedures (MAP) and establishing procedures for dispute resolution by arbitration.

Scope of the directive

The directive establishes rules to resolve double taxation disputes that arise from the interpretation and application of double tax treaties and EU conventions between EU member states. Double taxation includes an additional tax charge, and increase in tax liabilities or a reduction of losses that could be used to offset taxable profits.

Member states have the ability to deny access to the arbitration provisions of the directive, on a case-by-case basis, when the dispute does not involve double taxation. Cases also may be denied access when penalties are incurred for fraud, wilful default, or gross negligence. Domestic proceedings (e.g., judicial processes) may continue simultaneously.

Improvements to MAP

Businesses and individuals can initiate the mutual agreement process by submitting a complaint on a question of dispute to each of the competent authorities of the member states concerned. An administrative simplification is available for individuals and smaller undertakings. The complaint must be made within three years from the receipt of the first notification of the action resulting in the question of dispute. In a UK transfer pricing context, this would be the date of issue of a notice, letter, or amendment on the finalization of an enquiry that gives rise to double taxation.

The complaint must provide details of the relevant facts and circumstances of the case, the nature and date of the actions giving rise to the question in dispute, and an explanation of why the business or individual considers that there is a question in dispute. The competent authorities can request additional information within three months from the date of receipt of the complaint, and this should be provided within three months. The competent authorities are required to accept or reject the complaint within six months of receiving the information.

There are limited grounds for rejecting a complaint: there is no question in dispute, the complaint was not timely, or the required information has not been provided correctly. The business or individual is entitled to appeal a rejection, and the process for doing so is determined by whether one or all competent authorities reject the complaint.

Competent authorities must endeavor to resolve the dispute by mutual agreement within two years of acceptance (extendable to three years). Once a resolution is agreed upon, the decision is binding regardless of any domestic time limits, subject to acceptance by the business or individual.

Dispute resolution by mandatory binding arbitration

When the competent authorities fail to resolve the question in dispute by mutual agreement within the time frame provided, the business or individual has 50 days to request that arbitration procedures commence. An advisory commission will be set up within 120 days, and it must deliver its opinion on how to resolve the dispute within six months (extendable by three months if necessary). Businesses or individuals may appear before the advisory commission at their request, and must appear if required by the commission.

The advisory commission will consider the evidence provided, the provisions of the applicable double tax treaty, and the domestic law of the member states concerned, and adopt an opinion by simple majority. The competent authorities have an additional six months to adopt a final decision. This can differ from the advisory commission's opinion, but if the competent authorities fail to reach an agreement they will be bound by the advisory commission's opinion. Subject to the business or individual accepting the final decision, the final decision is binding and will be implemented regardless of time limits in domestic tax legislation.

The final decision will not create precedent. Every decision will be published (either in full or, at the request of the business, individual, or competent authorities, in an anonymized, summarized form) and will be made publicly available by the European Commission.

An advisory commission will be comprise of a chair, up to two representatives of each competent authority, and up to two "persons of independent standing" appointed by each competent authority.

There are criteria for selecting independent members, including that they should not be employees of tax authorities, nor have given tax advice on a professional basis for at least three years (five years in relation to the business, individual, or tax authorities concerned) and must offer a sufficient guarantee of objectivity. The chair, typically a judge, will be elected by the other members of the advisory commission from a collective list of suitable persons nominated by each EU member state. In most cases, the costs of the advisory commission will be borne by the member states involved.

Choice of arbitration process

Any other type of dispute resolution process is also acceptable, including the "final offer" (otherwise known as "last best offer" or "baseball") arbitration process, whereby each competent authority presents their final offer, with reasons, and the advisory commission chooses one outcome from the two presented. Alternatively, competent authorities may establish an Alternative Dispute Resolution Commission, with more flexibility in its composition but subject to the same timetable and independence rules.

Next steps and timetable

The directive will be adopted by ECOFIN later in 2017 (once the European Parliament has issued an opinion). Member states are to adopt the directive in their domestic legislation by 30 June 2019. ECOFIN will review the operation of the directive in 2024.

The directive will apply to complaints submitted after 1 July 2019 relating to tax years starting on or after 1 January 2018. Competent authorities may agree to apply the directive to complaints submitted earlier and/or for earlier tax years. Application of the directive in the UK will depend on the UK's agreements with the European Union at that time.

Comments

Effective resolution of disputes that could lead to double taxation remains an essential objective of double tax treaties and is key to removing one of the barriers to international trade. The number of disputes between tax authorities globally continues to rise. There are substantial improvements in the directive compared to the current EU Arbitration Convention, which applies only to transfer pricing disputes and the attribution of profits to permanent establishments.

The directive will apply to all instances of double taxation under double tax treaties and the timelines for settlement will be enforced.

The key benefit of a binding arbitration process is the persuasive effect it has on competent authorities' ability to reach agreement under the MAP, without the need to resort to arbitration. It is expected that relatively few cases will go to arbitration. The option of 'baseball arbitration' using final offers from competent authorities is helpful, and if selected could result in swifter resolution and reduced arbitration costs.

There are some weaknesses in how the arbitration process has been defined, including having representatives of each competent authority on the arbitration panel. Allowing businesses to request to appear before the arbitration panel and also to choose whether to accept the arbitration decision may be welcome by some, but could delay the process and may be a barrier to the finality of the arbitration. It also would be preferable if any domestic proceedings were suspended during the arbitration. The directive contains safeguards regarding confidential business information. Some businesses may have concerns about the publishing of decisions (although the decisions will be anonymized and in summarized upon request). Publishing decisions is a mixed benefit, because they will be of limited precedent value and will add more time to the process.

The directive applies to disputes between EU member states, and it is essential that countries are not deterred from adopting the broader mandatory binding arbitration clauses in the G20/OECD's Multilateral Convention, which may have potentially broader effect and more benefits.

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Reflections on the *Chevron* debt financing transfer pricing case – a post-BEPS decision?

On 21 April 2017, Australia's Full Federal Court rejected an appeal by the taxpayer in a case involving a credit facility extended to Chevron Australia Holdings Pty Ltd (CAHPL) by a US resident subsidiary of CAHPL. This is the first Australian transfer pricing court case on the issue of related-party loans. The case involved approximately $340 million in tax and penalties covering the 2004-08 period.

Chevron announced in May that it will appeal the Full Court's decision to Australia's High Court.

The US subsidiary had borrowed the funds ($2.5 billion AUD equivalent) externally in USD at an interest rate of around 1.2 percent, with the benefit of a guarantee from the ultimate parent company, Chevron Corporation (CVX). It then on-lent the funds to CAHPL at an interest rate of 1 month AUD LIBOR + 4.14 percent (which equalled around 9 percent in the period under review). This interest rate was based on a stand-alone credit rating of CAPHL and transfer pricing analysis using the actual terms and conditions of the facility.

The ATO had issued CAHPL with transfer pricing assessments on the basis that the interest rate on the loans was considered to be in excess of an arm's length rate. The assessments were raised under two separate transfer pricing provisions, Division 13 of ITAA 1936 and Subdivision 815-A of ITAA 1997.

In addition to the substantive interest rate issue, the Full Court also considered a number of procedural and legal matters, including:

- Whether the determinations under Division 815-A (which has retrospective effect to income years commencing on or after 30 June 2004) were constitutionally valid; and
- The impact of the fact that the ATO officer who made the assessments was not properly authorized.

The Full Court upheld the earlier decision of Robertson J that CAHPL had not shown that the interest paid under the credit facility agreement was equal to or less than arm's length. CAHPL therefore failed to prove that the amended assessments imposed by the Commissioner under Division 13 were excessive. This point is important, because under section 14ZZK(b) of the Taxation Administration Act 1953, the onus of proof was on CAHPL to prove that the assessments were excessive. As such, the commissioner did not have to argue every technical aspect of his assessments.

In detail

The key points of the judgement are as follows:

- Relevant in the post-BEPS environment, the judgment affirmed the role of the transfer pricing provisions as part of the anti-avoidance arsenal available to the commissioner. Further, the court held that Division 13 should be applied taking into account the intent of the legislation and real world commercial considerations, and should not be interpreted in a restrictive manner. It is clear that the transfer pricing provisions give the commissioner broad powers to substitute a more commercially realistic transaction when the actual transaction is considered to be, in whole or in part, one that could not occur in the open market.
- From a legal perspective, the defects in the making of the determinations, which gave effect to the relevant assessments, did not affect the validity of the assessment and did not assist the taxpayer in seeking to set those assessments aside. The decision reaffirmed the critical burden of proof in tax cases, which rests with the taxpayer, and the court's willingness to determine matters in a way that is fair, without unduly relying on administrative technicalities.
- The Full Court confirmed the decision of the trial judge, Robertson J, in holding that the arm's length inquiry retains the context and reality of a multinational group, and found that there was no reason to depart from the trial judge's view that an independent borrower like CAHPL, dealing at arm's length, would have given security and operational and financial covenants to acquire the loan, which would have resulted in a lower interest rate. This is particularly relevant when no senior secured debt is in place in addition to related-party debt arrangements.

- Consideration should be given to the availability of an explicit parental guarantee obtained by the borrower in a related-party financing transaction. When such a guarantee may be available, the interest rate would be expected to be lower; if not available, the taxpayer should be in a position to explain why not. Technically, the case was not decided on this issue, but Allsop CJ pointed out that even if CAHPL was unable to pledge security or agree to any financial and/or operational covenants, it would be of "no relevant consequence" if there was a reasonable expectation that Chevron (or a company in Chevron's position) would provide a guarantee. Similarly, Pagone J thought there was force behind the argument that CAHPL, in a hypothetical arm's length transaction, might have paid a guarantee fee to its parent, which the judge reasoned could still form part of the "consideration" paid by CAHPL, despite being paid to a third party to the loan (i.e., CVX). Ultimately, Pagone J determined there was insufficient evidence that such a fee would be part of the consideration paid by CAHPL in respect of a hypothetical loan. It is therefore possible that, in future cases, the courts may be persuaded by parental guarantee arguments advanced by either taxpayers or the commissioner.
- The Full Court decision included no guidance on the issue of passive affiliation (the concept that a third-party lender would take into account the wider group affiliation when assessing the creditworthiness of a subsidiary, when no explicit guarantee is provided). The trial court decision was not dismissive of the concept of parental affiliation. However, in that decision, Robertson J accepted CAHPL's submission that such implicit credit support had "little if any impact on pricing by a lender in the real world."
- The Full Court decision will have significant implications in applying the transfer pricing provisions in financing transactions. In such an environment, the specific profile of the borrower and the available support from its corporate parent or other related entity is critical in the determination of the arm's length cost of finance. However, given the importance of the facts in this case, it is unclear what the implications of this decision may be for different transaction types (for example, tangible goods or intangibles transactions).
- Justice Pagone saw no reason to depart from the Robertson J's conclusion that the hypothetical agreement reasonably might have been expected to be in Australian currency.
- In summary, the Full Court rejected an approach to transfer pricing that involved working out accurate pricing for the transaction that actually occurred. Instead, it suggested that the law allowed the commissioner to substitute a transaction that reflected how a company in the taxpayer's position would achieve the same commercial aims in an arm's length transaction. Accordingly, evidence about the taxpayer's usual commercial practices (or lack of such evidence) was central to key parts of the decision.

Impact

The decision will no doubt embolden the ATO, particularly in respect of the other financing audit cases that are currently underway, and in selecting new cases for audit. Senior ATO leaders have described intragroup financing as the number one risk they are focused on with regard to multinational taxation.

While this decision is predominantly a Division 13 decision, it is arguably consistent with the outcome that might be reached under Australia's new transfer pricing laws, Subdivision 815-B (for income years commencing after 30 June 2013), which include what are referred to the "reconstruction powers" (section 815-130), and are explicitly linked to the OECD transfer pricing guidelines. While the Full Court was unclear on the extent to which Division 13 allowed for reconstruction of the actual terms and conditions of the loan, it nonetheless reached the conclusion that CAHPL, had it been acting independently and dealing with a third-party lender, would have been expected to give security and operational and financial covenants to acquire the loan. The Full Court adopted this approach by relying on the testimony of two expert witnesses, ironically provided by Chevron, who testified that a loan of a comparable size in the oil and gas sector would not have been made by an independent lender in the absence of such requirements. The appropriate security and covenants also would have served to reduce the interest rate applied to a comparable loan by an independent lender.

Within the constraints of Division 13 (which is narrower than the current transfer pricing rules in Subdivision 815-B), the "reconstruction" of certain terms in the facility agreement was considered to be appropriate on the basis of the Full Court's view that security, covenants, and a parental guarantee form part of the "consideration" provided for acquiring the "property" (the credit facility in this case).

This type of commerciality overlay and mindset applied by the Full Court is consistent with the current OECD view as reflected in the BEPS project. Thus, notwithstanding that the arrangement in this case related to the 2004-08 period, and was argued under prior laws, this decision could be considered a post-BEPS decision, and may be indicative of how future courts may consider financing when the OECD transfer pricing guidelines are relevant to local transfer pricing legislation. That is, the arm's length principle is more than the simple pricing of a given transaction (given the actual terms and conditions); it also encompasses the question whether an independent party, acting in its own best interests, would have entered into a transaction on those terms and conditions. In fact, Allsop CJ noted that it could be accepted without difficulty that an unsecured loan issued by a stand-alone company in CAHPL's position, with no operational or financial covenants, would have an interest rate above 9 percent.

A critical component of the Full Court's conclusion was that from a pricing perspective, a subsidiary should not be viewed as an "orphan" from the multinational group. That is, it should be viewed as it is, as part of a larger group, and its credit characteristics may potentially be influenced by its association with that larger group. This is consistent with the new OECD guidance in Chapter 1 of the BEPS Actions 8-10 final report. As noted above, the trial court did not consider in this case that implicit support would have a material impact on pricing. It is unclear how much this non-orphan view will impact the pricing of related-party dealings other than financing, such as the pricing of goods or services. Further, in the application of the "arm's length debt test" in Australia's thin capitalization provisions (Division 820), the legislation specifically requires that all connections of the Australian taxpayer with the multinational group be ignored. It seems that this approach provides the worst possible combination for taxpayers regarding their allowable debt deductions, with the arm's length *amount* of debt (above the thin capitalization "safe harbor") set without reference to the broader group, but the arm's length *price* of the debt required to be set with regard to the broader group. This may be a possible inconsistency in policy rationale, which will need to be monitored.

The original trial court decision included adverse comments on the use of credit ratings to ascertain the interest rates on loans. Indeed, in that case Robertson J dismissed the testimony of the many expert witnesses that were called before him. This may be attributed to the fact that Robertson J did not consider the transaction priced by the experts to be commercial in the first place. The Full Court on appeal did not discuss these issues and did not seek to compute an appropriate arm's length rate of interest for the loan, other than to say that the taxpayer had not discharged its burden of proof to demonstrate that the commissioner's assessments were excessive. Accordingly, in our view, there is still some uncertainty on the practicalities of pricing related-party loans, in the absence of a fully comparable pricing analysis undertaken by an independent lender.

This case also highlights the importance of internal agreements and group policies. The rights and obligations conferred in the credit facility agreement, the Chevron group's internal policies, and its decision-making processes regarding financing arrangements were taken into account by the Full Court in reaching its decision as to an arm's length arrangement that might have been entered into by CAHPL.

Action

The decision provides the first substantive judicial guidance in Australia on the difficult territory of establishing arm's length financing arrangements between related parties. It gives taxpayers much to consider and apply in evaluating their own arrangements.

Specifically, the lesson learned for taxpayers that have, or are contemplating, intragroup financing arrangements is the need to demonstrate the commercial context of the intercompany arrangement, including bringing forth supporting evidence. This review may cover areas such as:

- Existing group policies on financing and parental security;
- The role of subsidiary companies in the group structure;
- Alternative related-party arrangements that were considered (and reasons for rejection, if appropriate); and
- Other evidence that supports the commerciality of the pricing of the taxpayer's arrangement.

Consequently, we would recommend that taxpayers review both their historic and prospective related-party financing arrangements in light of the decision. This would include a review of all intercompany arrangements and legal agreements and all background information and documentation that would assist in determining how best to defend the position in the event of an ATO review, and any requirements to restructure their arrangements, or seek certainty from the ATO via an advance pricing arrangement.

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IRS enters into initial country-by-country reporting exchange agreements

The US IRS has started signing its initial bilateral country-by-country (CbC) reporting competent authority arrangements (CAAs), the government-to-government agreements under which CbC reporting information will be exchanged. CAAs have been signed with the Netherlands, New Zealand, Norway, and other yet-to-be-named countries.[4] The text of the CAA between the United States and the Netherlands has been posted on the IRS's website.
URL: https://www.irs.gov/pub/irs-utl/netherlands_competent_authority_arrangement.pdf

Typically, CAAs like these are published in full by the IRS and the treaty or tax information exchange agreement (TIEA) partner, as long as both competent authorities agree to do so. It is expected that all CbC CAAs, including the ones already signed, will contain language similar to that in section 3(2) of the model CAAs that the IRS released on April 18, 2017. That section of the model CAAs appears to address potential concerns regarding whether voluntary filings with the IRS for 2016 tax years that begin before the effective date of Treas. Reg. §1.6038-4 (the 2016 gap year) will be respected by the other country. As long as that language has been included in a CAA, voluntary filing for the 2016 gap year should be respected.

US-Netherlands CAA observations

The text of the CAA between the United States and the Netherlands is very similar to the text of the US model CAA (on the basis of a double tax convention). There are a few differences, however, as well as an expected clarification regarding voluntary filing for the 2016 gap year. Each of these issues is discussed below.

Definition of "constituent entity": Same in substance as US Model CAA but different for US MNE groups and Dutch MNE groups: One difference between the US model CAA and the US-Netherlands CAA is the definition of "constituent entity." For US MNE groups, both the US model and the US-Netherlands CAA refer to the definition in the US Treasury regulations. With respect to MNE groups in the other jurisdiction, the US model duplicates the definition found in the OECD Model Legislation and Model Multilateral Competent Authority Agreement.[5] The US-Netherlands CAA, in contrast, refers directly to the "relevant Netherlands tax law." Given that the relevant Netherlands tax law is based on the OECD definition, there is no substantive difference between the two formulations.

However, there appears to be a different definition of constituent entity when comparing the definition in US Treasury regulations compared to the definition used in the OECD and Dutch rules. Specifically, the definition of "constituent entity" in the Dutch rules is based on accounting consolidation rules, consistent with the BEPS Action 13 final report. In contrast, the definition of "constituent entity" under the US Treasury regulations excludes foreign corporations or foreign partnerships for which there is insufficient control under I.R.C. §6038(a).

Therefore, the definition of "constituent entity" for Dutch MNE groups is potentially broader than the definition of "constituent entity" for US MNE groups. This could make a difference in the types of entities that would have to be reported on the CbC report for each country. For example, under the US Treasury regulations, certain variable investment entities (VIEs) need not be reported on the US MNE group's CbC report if the group's ownership of such VIEs was 50 percent or less.

Definition of "fiscal year": Same in substance as US Model CAA and same for US MNE groups and Dutch MNE groups: The definition of the term "fiscal year" in the US-Netherlands CAA is slightly different from that in the US model CAA, but the substance appears to be the same. In addition, the substance of the definition for both US and Dutch MNE groups appears to be the same, as discussed below.

[4] At the time of writing, other CbC CAAs were being released; however, this alert examines only the US-Netherlands CAA. The CAA with Norway follows the US model CAA even more closely than the US-Netherlands CAA.
[5] http://www.oecd.org/ctp/transfer-pricing/beps-action-13-country-by-country-reporting-implementation-package.pdf

Under the US model CAA, the term "fiscal year" is defined as "the annual accounting period with respect to which the Reporting Entity prepares its financial statements." Under the US-Netherlands CAA, the definition of the term "fiscal year" defers to the relevant Netherlands tax law. These definitions are in substance the same, because they both base the relevant reporting period on the ultimate parent entity's fiscal year end.

With respect to US MNE groups, the definitions of "fiscal year" in the US model CAA and the US-Netherlands CAA are the same. Both defer to the definition of the "reporting period" as defined in the relevant US Treasury regulations. Furthermore, because the US CbC regulations are generally based on the ultimate parent entity's fiscal year end, as well, the definition of "fiscal year" under the US CbC regulations, the OECD model legislation, and Dutch tax law are all generally the same.

As a result, even though the definition of "fiscal year" in these different sections appears to be different, the substantive definition is still the same both for US MNE groups and Dutch MNE groups. As noted above, this is in contrast to the definition of the term "Constituent Entity," which is potentially narrower for US MNE groups than for Dutch MNE groups.

Voluntary filing for 2016 gap year: Should be respected: As noted above, the US-Netherlands CAA addresses potential concerns regarding voluntary filings with the IRS for the 2016 gap year. Section 3(2) of the US-Netherlands CAA mirrors the language in the corresponding section of the US model CAA, and provides that the United States and the Netherlands intend to exchange CbC reports with respect to fiscal years beginning on or after 1 January 2016. This would include reports filed voluntarily with the IRS for the "gap years" beginning on or after 1 January 2016, but before the effective date of the final US regulations on 30 June 2016.

The US-Netherlands CAA states that it becomes operative on the date when the second competent authority signs the CAA. This suggests that the Netherlands does not need to submit the CAA to Parliament or undertake further ratification procedures for it to become operative.[6] Taken together with the language in section 3(2), this appears to support the expectation that 2016 gap year voluntary filings with the IRS will be respected under the US-Netherlands CAA.

Conclusion

These developments are promising news for US multinationals, as CAAs will permit taxpayers to file their 2016 CbC reports with the IRS rather than with foreign governments (via either local or surrogate filings). US multinationals whose tax year begins before 30 June 2016, and who file on extension, will generally be able to file their first CbC reports with the IRS when they file their 2016 tax return.[7] US multinationals whose tax year begins before 30 June 2016, and who do not file on extension, will generally need to file the CbC report using the amended return option described in Rev. Proc. 2017-23.[8]

The IRS has stated that negotiating additional CbC CAAs is a top priority over the next few months. As agreements are concluded, the IRS will update the CAA page on irs.gov to provide a list of the jurisdictions with which it has entered into CAAs. We will continue to provide updates as more CAAs are entered into and as more details about individual CAAs are made public.

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[6] Other countries that enter into future CAAs with the United States may adopt a different approach.

[7] For example, C corporations now have an extended due date of October 16, 2017, and Rev. Proc. 2017-23 states that the IRS will not start accepting CbC reports until September 1, 2017. As a result, calendar-year US multinational C corporations will be able to file their first CbC reports when they file their 2016 tax return in October 2017. For questions concerning due dates and tax returns for other types of entities or C corporations with a fiscal year, please contact a member of Deloitte Tax LLP's Washington National Tax.

[8] This will be the case, for example, for calendar-year C corporations and C corporations whose fiscal year ends on March 31, 2017. However, because of Rev. Proc. 2017-23's permissive rule for amending a taxpayer's 2016 income tax return, the IRS has effectively extended the deadline for Form 8975 to December 31, 2017, for calendar-year C corporations, at least for the first early reporting period. For more information on Rev. Proc. 2017-23 and the permissive rule for amending a taxpayer's 2016 income tax return for CbC purposes, see Global Transfer Pricing Alert 2017-005, dated March 21, 2017.
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-17-005-21-march-2017.pdf

URL: https://www.irs.gov/individuals/international-taxpayers/competent-authority-arrangements

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Brazil issues additional guidance on CbC reporting rules

The Brazilian tax authorities published guidance on 25 May that amends the 2016 normative ruling that introduced the country-by-country (CbC) reporting obligation in Brazil effective from fiscal year 2016.

According to the new guidance – Normative Ruling 1,709/2017 – for FY 2016, the Brazilian tax authorities will allow an ultimate parent entity (UPE) that is resident in a country that has not signed a competent authority agreement (CAA) for the exchange of CbC reports with Brazil to be designated as the reporting entity of the group on a conditional basis, provided the UPE's jurisdiction allows for voluntary filing in FY 2016.

If a CAA is not signed with Brazil by 31 December 2017, the Brazilian constituent entity may amend its corporate income tax return (which would have been filed by 31 July 2017) within 60 days (of 31 December 2017) and file the CbC report on behalf of the entire group, or it may designate an adequate surrogate entity.

The new NR provides additional clarification and should be read in conjunction with previous guidance issued by the tax authorities. The authorities acknowledge the challenges facing Brazilian constituent entities that are part of multinational groups with UPEs located in countries that have not yet signed a CAA, and wish to ensure flexibility in this regard.

The possibility that a Brazilian constituent entity may amend its corporate income tax return is an indication from the authorities that the heavy penalties associated with incorrect filing of a corporate tax return will not be applied to taxpayers that designate their UPEs as the reporting entity on a conditional basis, under the assumption that a CAA will be signed in the short term (for example, the CAA with the United States).

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OECD releases additional guidance on CbC reporting

The OECD on 6 April released additional guidance on the implementation of the country-by-country (CbC) reporting requirement introduced in the BEPS Action 13 final report. This guidance consolidates and expands all the additional guidance issued by the OECD since the release of the Action 13 final report. This includes the additional guidance issued on 29 June 2016 and 5 December 2016 (for prior coverage, see Global TP Alerts 2016-023 and 2016-038). Because the 6 April release includes all the information found in the 29 June and 5 December releases, going forward it will only be necessary to refer to the 6 April guidance when consulting OECD additional guidance on the Action 13 final report.
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-023-1-july-2016.pdf
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-038-6-december-2016.pdf

To assist jurisdictions with the introduction of consistent domestic rules, the additional guidance clarifies several interpretation issues related to the data to be included in the CbC report, as well as to the application of the model legislation contained in the Action 13 final report.

The OECD's additional guidance covers:

- The definition of revenues *(new)*;
- The definition of related party, for purposes of completing Table 1 of the CbC report *(new)*;
- The application of CbC reporting to investment funds *(unchanged)*;
- The application of CbC reporting to partnerships *(unchanged)*;
- The accounting principles/standards for determining the existence of and membership of a group *(new)*;
- The treatment of major shareholdings *(new)*;
- The impact of currency fluctuations on the agreed EUR 750 million filing threshold *(unchanged)*;
- The definition of total consolidated group revenue *(new)*;
- Transitional filing options for MNEs to address differences in effective dates ("parent surrogate filing") *(updated)*; and
- CbC reporting notification requirements for MNE groups during the transitional phase *(unchanged)*.

As described by the OECD:

> The additional guidance clarifies several interpretation issues related to the data to be included in the CbC report as well as to the application of the model legislation contained in the Action 13 report, to assist jurisdictions with the introduction of consistent domestic rules. *Five specific issues are addressed in this guidance: the definition of revenues; the accounting principles/standards for determining the existence of and membership in a group; the definition of total consolidated group revenue; the treatment of major shareholdings; and the definition of related party for purposes of completing Table 1 of the CbC report.* (Emphasis added.)

Definition of revenues (new)

The guidance clarifies that extraordinary income and gains from investment activities should be included in the "Revenues" column of the CbC report.

Definition of related parties (new)

For reporting related-party revenue by jurisdiction, related parties has the same meaning as constituent entities. This clarifies the Action 13 final report, which generally refers to "associated enterprises" for this purpose.

Accounting principles/standards for determining the existence of and membership of a group (new)

The guidance provides (with respect to the model legislation in the Action 13 report) that if the equity interests in an ultimate parent entity are traded on a public securities exchange, the group will be required to use the consolidation rules in the accounting standards it already employs (those standards that already apply for consolidated financial statement purposes).

Conversely, if the equity interests in an ultimate parent entity are not traded on a public securities exchange, the group may be allowed to choose to use either the local GAAP of the jurisdiction of the ultimate parent entity (including US GAAP, when permissible) or IFRS as its governing accounting standard. The guidance points out that the group must apply this choice consistently across years and for other aspects of the CbC report that require reference to an accounting standard.

The guidance notes that if the jurisdiction of residence of the enterprise that would be the ultimate parent entity mandates the use of a particular accounting standard for enterprises the equity of which are traded on a public securities exchange, this mandatory standard must be used.

The guidance explains that if a jurisdiction's consolidation rules generally require investment entities to be consolidated with investee companies, the jurisdiction may mandate the use of IFRS consolidation rules, for the purpose of determining the membership of a Group. A deviation such as this from the accounting standards generally followed for the CbC report of an MNE group should be noted in Table 3 of the CbC report.

Treatment of major shareholdings (new)

The guidance provides that if accounting rules in the jurisdiction of the ultimate parent entity require a constituent entity, the minority interests of which are held by unrelated parties, to be fully consolidated, then 100 percent of the entity's revenue should be included in the previous year's consolidated group revenue for purposes of applying the EUR 750 million threshold and identifying it as an excluded MNE group. The entity's financial data included in the CbC report should represent the full 100 percent amount and should not be prorated.

The guidance further states that if the accounting rules require proportionate consolidation in the presence of minority interests, the jurisdiction *may allow* the entity's revenue to be prorated for the purpose of applying the EUR 750 million threshold and may also allow the financial data that is included in the CbC report to be prorated. This appears to be limited to certain jurisdictions with local GAAP rules that provide for this type of proportionate consolidation.

Definition of total consolidated group revenue (new)

The guidance states that, in determining whether the total consolidated group revenue of an MNE group qualifies it as an excluded MNE group (total revenue less than EUR 750 million or near equivalent amount in the domestic currency as of January 2015), all revenue that is or would be reflected in the consolidated financial statements should be included. A jurisdiction where the ultimate parent entity resides is allowed to require inclusion of extraordinary income and gains from investment activities in total consolidated group revenue, if those items are presented in the consolidated financial statements under applicable accounting rules.

The guidance provides further clarification for financial entities that may not record gross amounts from transactions in financial statements with respect to certain items. For those entities, items considered similar to revenue under the applicable accounting rules should be used in the context of financial activities. Entities could apply labels to those items such as "net banking product" or "net revenues," for example. The label to be applied will depend on the accounting rules.

Parent surrogate filing (updated)

When surrogate filing (including parent surrogate filing) is available, it will mean that there are no local filing obligations for the particular MNE in any jurisdiction that otherwise would require local filing in which the MNE has a constituent entity (herein referred to as the local jurisdiction). This is subject to certain conditions, as listed in the guidance.

The guidance provides updates regarding some of the countries that have indicated they will allow parent surrogate filing (*i.e.*, voluntary filing in the parent jurisdiction). The original list of countries from the June 2016 guidance was supplemented in the December 2016 guidance, and our prior coverage (see Global TP Alert 2016-038) noted that change. The list of countries in the April 2017 guidance has remained the same. The list includes: Hong Kong, Japan, Liechtenstein, Nigeria, Russia, Switzerland, and the United States. In Liechtenstein, parent surrogate filing has moved from being contemplated in draft legislation to being approved. In Switzerland, parent surrogate filing is now contemplated in draft legislation, subject to parliamentary approval and referendum.
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-16-038-6-december-2016.pdf

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John Hughes appointed permanent director of IRS's Advance Pricing and Mutual Agreement Program

The IRS has named John Hughes as permanent director of its Advance Pricing and Mutual Agreement (APMA) Program, as reported in Bloomberg BNA's *Transfer Pricing Report*. Hughes has served as acting director of the APMA Program since July 10, 2016, taking over from former Director Hareesh Dhawale.

Hughes joined the IRS in September 2011. Prior to serving as acting director, Hughes worked as a senior manager in the APMA Program and as senior international advisor to the Treaty and Transfer Pricing Operations practice within the IRS's Large Business and International Division. Hughes was in private practice before joining the IRS.

Hughes will be the third director of the APMA Program, which was formed in early 2012 when the IRS's Advance Pricing Agreement Program merged with a portion of the Office of the US Competent Authority. The APMA team negotiates transfer pricing agreements with taxpayers and foreign tax authorities and works to resolve transfer pricing cases under the mutual agreement procedure articles of US bilateral income tax treaties.

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