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OECD releases additional guidance on attribution of profits to permanent establishments

The Organisation for Economic Co-operation and Development (OECD) on 22 March 2018 released additional guidance on the attribution of profits to a permanent establishment (PE) under action 7 of the base erosion and profit shifting (BEPS) project. This latest guidance was preceded by two discussion drafts, one issued in July 2016 and the other in June 2017. The 2018 guidance sets out high-level general principles in light of the comments received on the earlier drafts, but doesn't address the most challenging issue – rationalizing the application of articles 7 and 9 to the same legal structure.

Background

Action 7 of the BEPS action plan mandated the development of additional guidance on the issue of attribution of profits to PEs, in particular for PEs outside the financial sector. The final report on action 7, which was released in 2015, focused on whether the existing rules would be appropriate for determining the profits allocated to PEs. The final report concluded that, even though substantive modifications to Article 7 of the OECD Model Tax Convention (MTC) were not necessary, additional guidance was needed on how the rules would apply to the new definitions of a PE contained in Article 5 of the MTC.

The 2016 discussion draft presented two types of fact patterns the OECD felt would particularly benefit from additional guidance on attributions of profits to a PE. Those fact patterns were: (i) dependent agent PEs (DAPEs), including those created through commissionaire and similar arrangements; and (ii) warehouses as fixed place of business PEs. The 2016 discussion draft explored through a series of numerical examples potential differences that may result from attributing profits to these new PEs under the Authorized OECD Approach (AOA) versus under Article 9 of the MTC, which deals with transactions between associated enterprises.

The 2017 discussion draft moved away from the numerical examples and instead set out high-level general principles. Some commentators viewed this new approach as not being as useful, because it failed to help taxpayers and tax administrators deal with the fundamental issues relating to the application of the AOA outside the financial services context – the core task that Working Party 6 (WP6) had set out to resolve.

Most problematic was the lack of clarity on how to apply Articles 7 and 9 of the MTC together. The AOA relies on the concept of significant people functions (SPFs) to allocate assets and risks to the PE hypothesized in step one of the AOA, whereas Article 9 relies on the risk control framework of Chapter I of the OECD 2017 Transfer Pricing Guidelines (2017 TPGs). The 2017 discussion draft did not provide any additional guidance on how these differences between the AOA and Article 9 would translate into profit attribution to a PE, and for that reason many observers found it wanting.

Nevertheless, the 2017 discussion draft did provide some helpful guidelines affirming that: (i) there should be no double taxation as a result of attributing profits to a PE; (ii) through the accurate delineation of the transaction, the net amount of profits attributable to the PE might be positive, zero, or even negative; and (iii) source countries may continue to adopt administratively convenient ways of recognizing the existence of a PE and collecting the appropriate amount of tax resulting from the activity in the host country. The 2017 discussion draft also provided four examples that were intended to illustrate how the attribution of profits analysis should be applied. Some commentators, however, felt those examples were too general to be useful.

2018 guidance

The 2018 guidance maintains the same approach as the 2017 discussion draft. In particular, it continues to affirm that there should be no double taxation when attributing profits to a PE, either through the double counting of risks or in the combined application of Articles 7 and 9 of the MTC. It also reaffirms that the net profit attributable to a PE may be positive, negative, or a loss. Finally, the 2018 guidance continues to provide that countries may keep implementing administratively convenient procedures for recognizing the existence of a PE and collecting the tax in the host country, regardless of whether they have adopted the AOA. However, there is no recommendation or requirement that they do so.

The 2018 guidance also includes the four examples from the 2017 discussion draft but revises them to provide a more robust analysis of how the profits would be attributed to the PEs. The revised examples now go step-by-step through the AOA, detailing the SPFs hypothesized as being performed by personnel of the PE and the internal dealings between the PE and head office in the home country.

As discussed in more detail below, the first example illustrates the specific activities exemption and the anti-fragmentation rule under Articles 5(4) and 5(4.1) with respect to a warehouse and office PE. The remaining three examples involve fact patterns whereby Articles 7 and 9 of the MTC would be applied in combination to an Article 5(5) DAPE.

Observations

Despite the additional analysis in the examples, many of the most important questions remain unanswered. For instance, it is still unclear how the 2018 guidance fits into the overall framework of the current OECD guidance relating to the attribution of profits to a PE, and therefore the degree to which member jurisdictions are committed to following the guidance.[1] The executive summary states that the 2018 guidance is designed to provide high-level general principles, but left unspecified is whether the new guidance is designed to supplement the current AOA rules or act as commentary to them.

The 2018 guidance also fails to address the lack of a common set of concepts and language between the AOA, which is applicable in Article 7 cases, and an analysis under Article 9. In the absence of such harmonization of the two approaches, the result in any particular case may differ depending on which analysis is performed first – the Article 7 or the Article 9 analysis. The revised examples, though providing more details on how the AOA would apply, do not provide any additional clarity on this crucial issue.

Example 1: The warehouse example: Example 1 of the 2018 guidance applies the steps of the AOA to a situation in which the home country enterprise maintains a warehouse in the host country. Importantly, the 2018 guidance concludes that there is an internal dealing between the warehouse PE and the head office of the foreign parent company, OnlineCo, such that the PE should be analogized to an entity that provides internal storage and delivery services to the head office. Of particular note, however, is what the functional and factual analysis does *not* assert – that the warehouse PE has the function, asset, and risk profile of a distribution company.

Under step two of the AOA, therefore, the arm's length pricing of the internal dealing would equal the amount that the parent company, OnlineCo, would have had to pay if it had obtained the storage and delivery services from an independent enterprise in the host country.

Examples 2 through 4: Articles 7 and 9 of the MTC applied to an Article 5(5) DAPE: Examples 2 through 4 all deal with variations on the same theme – the interaction of Articles 7 and 9 applied to an Article 5(5) DAPE. In each example, there is both a local enterprise (called the related intermediary in the guidance) and a PE of the home office in the host country. The 2018 guidance asserts that it should not matter in which order Articles 7 and 9 are applied, because either way double tax is to be avoided. Nevertheless, none of the examples resolves the fundamental question of how to apply both articles to the same legal structure. Instead, each example summarily applies Article 9 first and then just notes that the remuneration is found to be at arm's length taking into account the functions, assets, and risks of the related intermediary.

Thus, while not expressly stated in the examples, under the Article 9 risk control framework, the conclusion that the local intermediary is being compensated at arm's length must mean that the local intermediary has: (i) accurately identified its functions, assets, and risks; and (ii) priced the transaction in accordance with the arm's length standard. Arguably, in such a fact pattern, there should be no additional profits to attribute to the PE. None of the examples discusses this point, however, nor do they provide any additional guidance on how to apply Articles 7 and 9 together or how to reconcile the different concepts and language between the two approaches.

Conclusion

Without affirmatively reaching consensus that the Article 9 analysis precedes the Article 7 analysis (or *vice versa*), and without to harmonizing the SPF analysis under Article 7 with the risk control framework under Article 9, the 2018 guidance leaves unresolved the fundamental issue that WP6 set out to address post-BEPS.

— Bob Stack (Washington, DC)
Managing Director
Deloitte Tax LLP
bstack@deloitte.com

Jamie Hawes (Washington, DC)
Senior Manager
Deloitte Tax LLP
jhawes@deloitte.com

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[1] See the 2010 Report on the Attribution of Profits to Permanent Establishments (22 July 2010).

New Dutch transfer pricing decree incorporates BEPS guidance

The Dutch tax authorities on 11 May 2018 published a new transfer pricing decree in the official gazette that provides additional background and guidance on the domestic interpretation of the OECD transfer pricing guidelines, and adopts recent updates resulting from the OECD's BEPS project.

The new transfer pricing decree – Decree no. 2018-6865 of 22 April 2018 – replaces the transfer pricing decree of November 14, 2013. Most notably, the decree provides additional guidance regarding the application of the arm's length principle that aligns with the updated 2017 OECD transfer pricing guidelines, provides examples for determining the appropriate cost base, adopts the OECD's simplified approach for low-value-added services, and provides additional guidance and views regarding intangible assets and business restructurings.

Application of the arm's length principle

The decree confirms the detailed risk analysis introduced in the recent update to the OECD transfer pricing guidelines. Contractual agreements entered into by the parties are the starting point for the analysis of intercompany transactions; however, the decree emphasizes that if the parties' actual conduct is not in line with the contractual arrangement, the actual conduct will be considered the leading factor.

According to the Dutch authorities, arrangements whereby all risks are contractually assigned to one party may not be deemed to be arm's length if that party provides only a minimal contribution to the risk control function. Therefore, if multiple parties contribute to the control of economically significant risks, the profit split method could be an appropriate transfer pricing method.

Cost base

The functions performed, assets used, and risk assumed by the tested party are the basis of determining an appropriate cost base when using the transactional net margin method (TNMM) with a cost-based profit level indicator. As a specific example, the operating costs, excluding the raw materials, could be considered an appropriate cost base for a manufacturing entity that does not run risks in relation to the raw materials, based on its functional profile.

Low-value-adding services

The decree aligns with the OECD transfer pricing guidelines and allows a simplified approach for the determination of an arm's length remuneration for low-value-adding services, by applying a mark-up of 5 percent on costs. The application of the simplified approach assumes that appropriate allocation keys are used, and that substantiation in the form of documentation is prepared. As in the previous decree, the Dutch authorities, under certain conditions (described in Paragraphs 7.37 and 7.43 – 7.65 of the OECD transfer pricing guidelines) will allow a recharge of the relevant costs without a mark-up.

Intangible assets and business restructurings

The decree provides that the tax authorities will evaluate critically the use of databases that list royalty amounts of comparable transactions to determine the appropriate remuneration for the use of intangible assets. Instead, a residual profit approach could be more appropriate to determine the value of the use of intangible assets, assuming all other relevant functions, risks, and assets are appropriately remunerated.

Transfers of intangible assets can be considered to take place under arm's length conditions only when the assets are expected to increase the combined profit of the parties involved, requiring certain functionality of the intangible assets' buyer. The decree indicates that a transfer of intangible assets to a party that does not have the required functionality to contribute value to those intangible assets will be ignored for tax purposes.

For hard-to-value intangibles, under the new decree the tax administration may use actual results to challenge the original transfer value of intangible assets in cases of substantial deviation (defined as deviations of more than 20 percent in the first five years of the IP's commercialization) between the projected results used in the valuation of the intangible assets (there is no reference to value deviation as used in the OECD transfer pricing guidelines).

In addition, the decree expresses the Dutch tax authorities' view regarding specific considerations in relation to a business restructuring following the purchase of shares in an unrelated entity. The acquisition file is considered an essential component of transfer pricing documentation regarding the price of transferred intangibles in relation to the business restructuring. Other attention points include the relevance of the relation between the purchase price and the value of the intangible assets for the acquirer of the shares, the tax on capital gains upon transfer, and the limited time horizon when valuing routine functions.

Remarks

In addition to the differences between the new decree and the 2013 decree described above, the 2018 decree addresses other specific situations, including cost contribution arrangements, central procurement, loan guarantees, internal reinsurance activities, and considerations to subsidies.
As a final remark, the decree more explicitly indicates that in case of non-arm's-length transfer of profits, the Dutch authorities may impose penalties depending on the facts and circumstances of the specific case.

— Thijs Heijenrath (Rotterdam)
Partner
Deloitte Netherlands
THeijenrath@deloitte.nl

Sjoerd Haringman (Rotterdam)
Partner
Deloitte Netherlands
sharingman@deloitte.nl

Froukje Frerichs (Rotterdam)
Director
Deloitte Netherlands
FFrerichs@deloitte.nl

Ruud Jacobs (Den Haag)
Business Analyst
Deloitte Netherlands
RuJacobs@deloitte.nl

Zambia issues amended transfer pricing regulations

Following extensive consultations with various stakeholders in 2017, the government of the Republic of Zambia has issued amended transfer pricing regulations through a government gazette dated 6 April 2018.

The issuance of these regulations – Statutory Instrument No. 24 of 2018, the Income Tax (Transfer Pricing) (Amendment) Regulations, 2018 – is in line with the global trend whereby various countries are taking legal steps to adopt the Organisation for Economic Co-operation and Development's (OECD's) base erosion and profit shifting (BEPS) final recommendations.

The amendment seeks to enhance the existing transfer pricing regulations, issued in 1999/2000, by providing detailed guidance on the application of the arm's length principle and Zambia's transfer pricing documentation requirements. The new regulations, read together with the Transfer Pricing (Regulations), 2000, are hereinafter referred to as the transfer pricing regulations.

Below is a summary of key provisions of the transfer pricing regulations.

Who is affected by the regulations?

The transfer pricing regulations apply to both domestic and cross-border transactions between associated persons. According to the Income Tax Act, two persons are associated if one person participates directly or indirectly in the management, control, or capital of the other or both of them.

The application of transfer pricing regulations to domestic transactions between associated persons within Zambia is not a unique development, as many countries in the region have adopted similar rules; however, most transfer pricing rules focus on cross-border transactions when the parties are located in different tax jurisdictions, thereby creating a potential for shifting profits from one country to the other. This development may impose a compliance burden on taxpayers even when there is no significant risk of erosion of the Zambian tax base.

Recognition of OECD guidelines and United Nations practical manual

The transfer pricing regulations recognize the application of the OECD transfer pricing guidelines and the *United Nations Practical Manual on Transfer Pricing for Developing Countries*. However, the regulations and the Zambian Income Tax Act (ITA) will prevail in case of any inconsistencies.

Determination of arm's length price

The transfer pricing regulations are largely consistent with the OECD guidelines/UN transfer pricing manual, and similarly provide five methods to be applied in the determination of the arm's length price in transactions between associated persons ("controlled transactions"). These methods are the traditional transaction methods – the comparable uncontrolled price (CUP) method, the resale price method, and the cost plus method) – and the transactional profit methods – the transactional net margin method and the profit split method.

The transfer pricing regulations provide for the application of the most appropriate method, and allow taxpayers to apply to the Commissioner-General for approval of any other method, if the taxpayer can establish that none of the provided methods can reasonably be applied to the transaction.

Documentation requirements

Affected taxpayers should prepare contemporaneous documentation evidencing the arm's length nature of the controlled transactions for the relevant charge year. Documentation must be prepared on an annual basis, and maintained for six years. Documentation would be considered contemporaneous if it is in place by the due date of the annual income tax return, and should be submitted within 30 days upon request by the ZRA.

The regulations exempt persons who are not members of a multinational enterprise and whose turnover does not exceed ZMK 20 million (approximately USD 2 million) in any charge year from the transfer pricing documentation requirement. However, taxpayers would still be required to comply with the arm's length principle on their associated-party transactions.

Comparability analysis

The regulations provide general and specific guidance on comparability analyses to be performed by the taxpayer with respect to controlled transactions. The concept of comparability analysis is used in the selection of the most appropriate transfer pricing method, as well as to arrive at an arm's length price or financial indicator (or range of prices or financial indicators) and thus plays a central role in the overall application of the arm's length principle. The regulations provide five comparability factors that require consideration with respect to a controlled transaction, as follows:

- **Characteristics of the property or services:** Differences in the specific characteristics of property or services often account, at least in part, for differences in their value in the open market. Therefore, comparisons of these features may be useful in determining the comparability of controlled and uncontrolled transactions.
- **Functions undertaken, assets used, and risks assumed:** In transactions between two independent enterprises, compensation usually will reflect the functions that each enterprise performs (taking into account assets used and risks assumed). Therefore, in determining whether controlled and uncontrolled transactions or entities are comparable, a functional, assets, and risk analysis is necessary.
- **Contractual terms:** In arm's length transactions, the contractual terms of a transaction generally define explicitly or implicitly how the responsibilities, risks, and benefits are to be divided between the parties. As such, an analysis of contractual terms should be a part of the functional, assets, and risk analysis discussed above.
- **Economic circumstances:** Arm's length prices may vary across different markets even for transactions involving the same property or services; therefore, achieving comparability requires that the markets in which the independent and associated enterprises operate do not have differences that have a material effect on price or that appropriate adjustments can be made.
- **Business strategies:** Business strategies must also be examined in determining comparability for transfer pricing purposes. Business strategies would take into account many aspects of an enterprise, such as innovation and new product development, degree of diversification, risk aversion, assessment of political

changes, input of existing and planned labor laws, duration of arrangements, and other factors bearing upon the daily conduct of business. Such business strategies may need to be taken into account when determining the comparability of controlled and uncontrolled transactions and enterprises.

In addition to the general guidance discussed above, the regulations stipulate specific comparability considerations for the following associated-party transactions:

- **Acquisition of assets:** When used or new assets are acquired from nonresident associated persons, the taxpayer will provide the invoice payment, proof of date of acquisition of the asset from an independent third party, and delivery note. When the asset is sold in a state other than the state of purchase, or there is no third-party invoice, or the asset is built or assembled using different components of different invoices, a technical appraisal may be required.
- **Intragroup services:** The regulations stipulate that in justifying the arm's length nature of intragroup services, the taxpayer must demonstrate that the services were actually rendered and a benefit was conferred and/or the economic or commercial value enhanced the taxpayer's commercial position. Further, charges will be considered inconsistent with the arm's length principle if they relate to shareholder costs or activities, or are considered duplicative activities.
- **Low-value-adding services:** In line with the OECD guidelines, the regulations provide for a simplified approach to low-value-adding intragroup services, and consider the application of cost plus 5 percent mark-up as arm's length.
- **Intangible property:** Transactions involving the license, sale, or other transfer of intangible property should consider special factors of comparability, such as expected benefits of the intangible property, any geographical limitations on the exercise rights, exclusive or non-exclusive character of rights transferred, and the transferee's right to participate in further development of the intangible property.

Taxpayers will be required to take the above into account when setting or reviewing their transfer pricing policies for their controlled transactions.

Arm's length range

The transfer pricing regulations provide for the use of the interquartile range when the results include a sizeable number of observations and the taxpayer has made reasonable efforts to exclude points of lesser degree of comparability. When a taxpayer's results fall outside the arm's length range, the ZRA's Commissioner-General may adjust the taxpayer's results to the median. However, the regulations are silent on whether a downward adjustment to the median may be allowed when the taxpayer's income from a transaction falls above the interquartile range of the full results of benchmarking studies.
Corresponding adjustments

To eliminate economic double taxation arising from transfer pricing adjustments made in the counterparty's jurisdiction with respect to a controlled transaction, the regulations allow taxpayers to apply for a corresponding adjustment.

Penalties

Noncompliance with the regulations may result in an offense and liability upon conviction to penalties specified under the Income Tax Act.

Conclusion

The release of the regulations is a positive step and provides taxpayers with clearer guidelines in discharging their transfer pricing obligations. The regulations also signal the likelihood that the ZRA will launch more formal, rigorous, and perhaps more frequent transfer pricing audits. We are aware, based on ongoing transfer pricing audits, that in addition to the taxpayer's local transfer pricing file, the ZRA is requesting additional information not covered by the transfer pricing regulations, such as a country-by-country report (CbCR) and a master file, using statutory powers vested in the Commissioner-General under the Income Tax Act. It is now more urgent for taxpayers to review their transfer pricing policies and put in place required contemporaneous transfer pricing documentation.

— Victor Muhundika (Lusaka)
Partner
Deloitte Zambia
vmuhundika@deloitte.co.zm

Malcolm Jhala (Lusaka)
Associate Director
Deloitte Zambia
mjhala@deloitte.co.zm

Robert Ogutu (Nairobi)
Manager
Deloitte Kenya
rogutu@deloitte.co.ke

Poland's MOF discusses simplified APA procedure during first Transfer Pricing Forum

Poland's first Transfer Pricing Forum, a conference organized by the Ministry of Finance to provide a platform for discussion of transfer pricing issues for both the tax administration and business representatives, took place on April 12, 2018.

Benchmarking analyses were the principal subject of the first forum meeting. The MOF's ongoing transfer pricing work, especially the ministry's work regarding a simplified advance pricing agreement (sAPA) procedure, was also presented.

Interested parties may participate freely in upcoming forum meetings, which will be held quarterly.

Benchmarking analyses

For the conversation on benchmarking analyses, the EU's Joint Transfer Pricing Forum's *Report on the Use of Comparables in the EU* constituted the basis for discussion.
URL: https://ec.europa.eu/taxation_customs/sites/taxation/files/jtpf0072017encomps.pdf

The discussion was divided into subareas, corresponding to the eight JTPF recommendations regarding comparability analysis, including:

- Comparable search strategies;
- Use of internal and external comparables;
- Adjustments that increase the comparability of data; and
- Use of regional (local) and foreign (non-domestic) data.

During the meeting, the requirement to prepare a comparability analysis for low-value-added services was discussed. In the MOF's opinion, due to the current regulations concerning preparation of transfer pricing documentation, replacement of the benchmarking analysis with a simplified description of compliance prepared on the basis of relevant JTPF work cannot be deemed to fulfill the formal documentation requirements. The ministry also announced that introduction of the "safe harbor" concept into Polish legislation is being considered.

Simplified APA procedure

The ministry announced that a draft amendment to the Tax Ordinance Act introducing a simplified APA procedure has been submitted for internal consultations.

The goal of the sAPA is to confirm the transfer pricing methodology applied in the intragroup transactions concerning selected transaction types listed in art. 15e of the Corporate Income Tax Act. That article limits the tax deductibility of expenses related to intangible services (such as management fees) and intangible assets (such as trademark royalties) received from related entities. The limitation of the cost deduction does not apply to transactions covered by a sAPA.

Under the sAPA procedure, the taxpayer would be obligated to submit a standardized application including a descriptive section, as well as information on selected financial data and ratios. The application would not include financial forecast data (which is crucial for the standard APA procedure).

An sAPA would be issued for a three-year period (with the possibility to extend it), compared to standard APAs, which are issued for a five-year period.

The fee for an sAPA fee is expected to be significantly lower than the fee for the standard APA, and will not depend on the value of the transactions covered by the application.

Introduction of the sAPA to the Tax Ordinance Act is expected in June.

Other issues

As part of the process for the implementation of the simplified APA procedure into the Tax Ordinance Act, the ministry is also planning to introduce some amendments to the standard APA procedure. Specifically, the ministry may modify the rules so that a standard APA might be effective starting from the beginning of the year in which the standard APA application was submitted (limited rollback). Under the current legislation, an APA may cover the period starting from the time of submission of the standard APA application.

The ministry also announced plans to amend the legislation to allow taxpayers (with some limitations) to apply for an APA for transactions that are the subject of a tax audit or proceedings before administrative courts at the time of application. Currently, the APA path is unavailable in such cases.

Finally, the ministry confirmed plans to publish additional explanations – "frequently asked questions," or FAQs – regarding the CIT-TP and PIT-TP forms (simplified transfer pricing statements attached to the tax return for the given fiscal year).

— Iwona Georgijew (Warsaw)
Partner
Deloitte Poland
igeorgijew@deloitteCE.com

Rafał Sadowski (Warsaw)
Partner
Deloitte Poland
rsadowski@deloitteCE.com

Agnieszka Mitoraj (Poznan)
Director
Deloitte Poland
amitoraj@deloitteCE.com

Agnieszka Walter (Katowice)
Director
Deloitte Poland
awalter@deloitteCE.com

Tomasz Adamski (Warsaw)
Director
Deloitte Poland
tadamski@deloitteCE.com

Mariusz Kazuch (Warsaw)
Director
Deloitte Poland
mkazuch@deloitteCE.com

South Africa clarifies penalties for failure to submit CbC report, master file, and local file

The South African Revenue Service issued a notice on 11 May 2018 regarding the consequences for failing to submit a country-by-country (CbC) report and related transfer pricing documentation when required to do so.

The SARS notice clarifies that the fixed amount penalties provided in sections 210 and 211 of the Tax Administration Act, 2011, will be applicable. These penalties are prescribed amounts that escalate according to the taxpayer's assessed loss or taxable income. The minimum applicable penalty is ZAR 250 per month (approximately USD 20) for entities with an assessed loss or taxable income not exceeding ZAR 250,000 (approx. USD 20,000) and the maximum is ZAR 16 000 (approx. USD 13,000) per month for entities with a taxable income exceeding ZAR 50 million (approx. USD 4 million).

The documentation covered by the notice includes not only the CbC report itself, but also the other elements of transfer pricing documentation – the master file and the local file. Presumably, the fixed amount penalty will apply separately to each of the three elements, to the extent any of them are outstanding.

This notice applies only to entities with a CbC report filing obligation. As this stage, it is not yet clear whether the same penalties will apply to taxpayers that are obligated to submit transfer pricing documentation (that is, the master file and local file) but not a CbC report.

— Billy Joubert (Johannesburg)
Director
Deloitte South Africa
bjoubert@deloitte.co.za

Steven Breslin (Johannesburg)
Associate Director
Deloitte South Africa
stbreslin@deloitte.co.za

Bradley Pearson (Durban)
Associate Director
Deloitte South Africa
brpearson@deloitte.co.za

Cabrini McCarrick (Johannesburg)
Associate Director
Deloitte South Africa
cabmccarick@deloitte.co.za

Philip Fouché (Cape Town)
Associate Director
Deloitte South Africa
pfouche@deloitte.co.za

OECD invites comments on revisions to transfer pricing guidelines for intragroup services and dispute resolution

The OECD is scoping a new project to revise aspects of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in respect of:

- Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes (Chapter IV); and
- Intragroup services (Chapter VII).

Avoiding and resolving transfer pricing disputes

Relevant aspects of the BEPS work in relation to Making Dispute Resolution Mechanisms More Effective (Action 14), including the section on advance pricing arrangements (APAs), have already been incorporated into the guidelines. However, the OECD has determined that additional work could be done in relation to examination practices, mechanisms to prevent and resolve tax disputes, and risk assessment.

Comments are especially welcomed on the following points:

- Additional mechanisms to minimize the risk of transfer pricing disputes. Input is sought on business' experiences of advantages and/or challenges of mechanisms including cooperative compliance, risk assessment, and tax examination practices;
- Additional guidance in relation to corresponding and/or secondary adjustments to minimize the risk of double taxation;
- Any additional guidance that could be provided on APAs or specific initiatives that could minimize transfer pricing disputes, including implementation challenges;
- Other mechanisms or issues relevant to the administration of transfer pricing and/or prevention and resolution of disputes.

The OECD believes there is no need to revise or supplement current guidance on safe harbors and arbitration of disputes, but public comments are also invited on those points.

Special considerations for intragroup services

This chapter of the guidelines was updated in 2015, as part of the G20/OECD BEPS project, to incorporate a simplified approach for the transfer pricing of low-value-adding intragroup services.

Alignment with other updated BEPS guidance on intangibles, risks, and capital has been identified as a potential area of focus, along with any necessary consideration of the OECD's ongoing work on the use of profit split methods and financial transactions.

The scope will focus on the practical application of the existing guidance. The following practical challenges have been identified as requiring further analysis:

- Demonstrating that a service has been rendered and/or that the service rendered provides a benefit to the recipient;
- Drawing a distinction between (i) activities that do or do not benefit group companies; (ii) benefits that arise purely from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities;
- Identifying duplicated activities;
- Finding an appropriate allocation key for charging intragroup services;
- Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises; and
- Assessing arm's length pricing of services provided in connection with intangibles; services that are highly integrated with the value creation of the group; and/or involve significant risks.

Comments

It is important both for tax authorities and for businesses that clear guidance be available to prevent and resolve tax disputes. The incorporation of relevant aspects of the G20/OECD BEPS work in relation to *Making Dispute Resolution Mechanisms More Effective* is a helpful start. Further improvements could be made in respect of the conduct of transfer pricing audits, risk assessment, and transfer pricing adjustments.

Guidance on the transfer pricing of intragroup services was updated as part of the BEPS project to include a new approach to low-value-adding intragroup services, but challenges remain in this area. These relate in particular to practical aspects, such as application of the benefit test to service recipients, difficulties with costs (including the level of costs and identification), and challenges to deductions. It is particularly striking that the scoping paper uses the term "stewardship" alongside the narrower "shareholder activities," as this is a broader concept that has been largely retired from recent versions of the transfer pricing guidelines. This is an area in which double taxation is common despite the broad agreement among countries as to how services should be priced and the relative simplicity of pricing intragroup services (in comparison with, say, intangibles). The work will need to address evidentiary requirements so that they are proportionate and consistent from country to country, and are not so onerous that they lead directly to double taxation. It will be important for businesses that OECD inclusive framework countries reach broad consensus agreement on how to deal with the practical challenges.

Timetable and next steps

Comments are invited by 20 June 2018. The OECD (Working Party 6) aims to finalize their scoping exercise by the end of 2018.

— Bill Dodwell (London)
Partner
Deloitte United Kingdom
bdodwell@deloitte.co.uk

Shaun Austin (London)
Partner
Deloitte United Kingdom
saustin@deloitte.co.uk

Edward Morris (London)
Partner
Deloitte United Kingdom
edmorris@deloitte.com.uk

Alison Lobb (London)
Partner
Deloitte United Kingdom
alobb@deloitte.co.uk

John Henshall (London)
Partner
Deloitte United Kingdom
jhenshall@deloitte.co.uk

Clive Tietjen (Reading)
Partner
Deloitte United Kingdom
ctietjen@deloitte.co.uk

Panama modifies transfer pricing information reporting form

Panama's tax authorities announced on 9 April 2018 that the transfer pricing information form (Form 930) that must be submitted by taxpayers that engage in transactions with foreign related parties has been reformatted and updated. A resolution (No. 201-1937) published in the country's official gazette on the same date modifies the format for filing the return and contains a new version of the form (Form 930 V2.0) that requires additional information. The new resolution repeals previous resolutions dating from 2012.

Form 930 V2.0 is effective from 9 April (the date the resolution entered into effect), and will be required for fiscal years beginning on or after 1 January 2018. The form must be filed within six months after the end of the fiscal year. For fiscal years beginning before 1 January 2018, the former version of Form 930 remains applicable.

Overview of changes

The new version of the form was issued as a result of a 2016 decree that amended Panama's transfer pricing rules to bring them in line with the local file recommendations under action 13 of the OECD/G20 BEPS project. The new decree requires more information to be included in the transfer pricing study (the local file), and Resolution No. 201-1937 aligns the template for the presentation of the transfer pricing report with these changes.
URL: http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/transfer-pricing-documentation-and-country-by-country-reporting-action-13-2015-final-report_9789264241480-en
URL: http://www.oecd.org/tax/beps/

The new version of the form also seeks to streamline administrative processes and taxpayer supervision by the tax authorities, since it requests information on the comparable transactions selected for the transfer pricing study. Form No. 930 V2.0 must be submitted online through the "e-tax 2" website.

With the new format of the transfer pricing report, the tax authorities will have access to the economic information included as part of the transfer pricing study without having to make a specific request and wait for up to 45 business days (the period provided by law for taxpayers to respond to a request for the study). The additional economic information on the taxpayer and the selected comparable transactions will allow the tax authorities to make preliminary calculations of potential adjustments to the taxpayer's income tax base, and focus their audit efforts on taxpayers that are most likely to be in noncompliance with the arm's length principle.

Taxpayers should note that, due to the detailed information that must be reported regarding comparable transactions (see below), it will be necessary to prepare the transfer pricing study (or at least a draft) before filing Form No. 930 V2.0. Since the transfer pricing study must be filed only upon request, taxpayers generally have prepared the former version of Form 930 prior to the transfer pricing study.

Accompanying the new resolution are instructions for taxpayers regarding the information that must be included in the form. It is not possible to amend Form 930 V2.0. If a taxpayer submits a form containing an error, its only option is to request a cancellation of the form from the General Director of Income, which has the discretion to grant or deny the request. If the request is granted, the taxpayer may submit a new report before the deadline for filing the form. The tax authorities are expected to issue additional guidance to clarify certain issues relating to the filing rules (for example, whether a taxpayer that discovers an error after the deadline for filing the form has any way of correcting the inaccurate information).

Specific changes to transfer pricing report

The following information now must be included in the transfer pricing reporting form:

- An economic analysis of each transaction carried out with foreign related parties (transactions may be grouped together in certain cases);
- The selected profitability ratio for each analysis;
- The taxpayer's profit or loss without adjustments, along with the value of the profitability ratio (expressed as a percentage); and

- If adjustments have been made to the profitability ratio, the taxpayer's adjusted profit or loss, as well as the value of the adjusted ratio.

Additionally, the form will include two annexes:

- An annex for reporting on intangible asset transactions, which must include the following:
  - The number of transactions involving intangibles, which include licenses for use, purchase, and/or sale;
  - The "operation code" indicating whether the item is an income or expense item;
  - The type of transaction, that is, whether it corresponds to royalties or the purchase or sale of an intangible; and
  - The type of intangible analyzed (for example, a brand, patent, know-how, software, intellectual property or "other").
- An annex for reporting on comparables, which must include information related to the companies selected as comparable, when this is required under the method selected for the analysis. The information to be disclosed includes the following:
  - Name of the comparable company;
  - Type of comparable (internal or external);
  - Location (local or foreign);
  - Country of residence of the comparable company;
  - Profitability ratio used for the comparable company, with the options being gross margin on costs or sales, operating margin on costs and expenses, operating margin on sales, return on assets, return on capital employed, or Berry ratio;
  - Fiscal year of the comparable company (start and end date);
  - Sales used to calculate the profit ratio;
  - Cost of sales used to calculate the profit ratio;
  - Profit or loss resulting from the net of the two previous items;
  - Operating expenses used to calculate the profit ratio; and
  - Operating profit or loss resulting from the difference between operating expenses and gross profit.

Both annexes can be imported into the electronic reporting template by using Excel files in a "tab-delimited text" (.txt) format, through the use of the nomenclature specifically detailed in the form's instructions.

In addition to the above, the taxpayer must answer questions in the transfer pricing form regarding itself and its business group:

- Regarding the taxpayer:
  - Whether it benefits from a special tax regime in Panama;
  - Whether it has been part of any corporate restructuring during the year that is the subject of the report;
  - Details of transfers of intangibles (if any);
  - Whether comparability adjustments were applied; and
  - Whether any companies selected as comparable had operating losses and/or were involved in certain business transactions (such as a restructuring or merger).
- Regarding the business group:
  - Whether the group has carried out a corporate restructuring during the year that is the subject of the report;
  - Whether a foreign related party is the subject of a transfer pricing audit;
  - Whether any foreign related party is or has been subject to a transfer pricing inspection;
  - The country of tax residence of the parent company;
  - The group's consolidated income, in the currency of the country where the parent is resident, and the year to which this income corresponds;
  - The currency in which the group's income is consolidated; and
  - Consolidated group income in US dollars, and the date of the exchange rate used for the conversion.

As in the previous version of the report, the name of the taxpayer's legal representative and his/her personal identification number must be indicated.

— Rosemari Cordero (Panama)
Director
Deloitte Panama
rcordero@deloitte.com

Carlos Fernandez (Panama)
Manager
Deloitte Panama
carlfernandez@deloitte.com

Irish Revenue release details on monitoring compliance with transfer pricing rules

The Irish Revenue on 28 May 2018 released a Tax and Duty Manual – "Monitoring Compliance with Transfer Pricing Rules" – that contains information regarding Irish Revenue's approach to monitoring compliance with domestic transfer pricing law in Ireland.

Details

The manual outlines details relating to the two programs used to monitor compliance with Irish domestic transfer pricing law:

- The Transfer Pricing Compliance Review program (TPCR); and
- The transfer pricing audit program.

Main Features of TPCR Program: The Irish Revenue originally introduced the TPCR program in November 2012, in advance of a formal transfer pricing audit program within Irish Revenue.

The TPCR program allows authorized officers from the Irish Revenue to send out notifications to selected taxpayers inviting them to self-review their transfer pricing and report back within three months. The review covers a specific accounting period.

The report to be provided to the Irish Revenue based on this self-review addresses:

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

In most circumstances, an existing transfer pricing study should suffice, as it is likely to include all the relevant points required.

The manual emphasizes that a TPCR is not a transfer pricing audit, and the information collated from the review is used by Irish Revenue in its risk assessment process for taxpayers. In certain circumstances, a case selected for a TPCR may be escalated to a formal audit. The manual cites two examples when this may occur – when the company declines to complete a self-review or when the output from the review and follow-up queries indicates that the arm's length principle is not adhered to.

Because the TPCR process is not a formal tax audit, a company retains the right to make an unprompted qualifying disclosure under the Code of Practice for Revenue Audit & Other Compliance Interventions at any time throughout or after the review concludes (and up to the point before the Irish Revenue provide notification of a formal audit).

Transfer Pricing Audit Program: A separate transfer pricing audit team was constituted within Irish Revenue in the Large Cases Division (LCD) in 2015. Transfer pricing audits in Ireland are undertaken in compliance with the Code of Practice for Revenue Audit & Other Compliance Interventions. The code provides an opportunity for companies to make unprompted qualifying disclosures before an audit notification letter is issued.

Irish Revenue have a standard schedule of information they normally request on the commencement of a formal transfer pricing audit, including:

- A corporate chart outlining the group structure and shareholdings of each group company;
- Organizational chart outlining the different functional areas, employee titles, and reporting lines;
- Details of relevant related-party transactions, including a brief description of each transaction, together with the name of each counterparty and a summary of the material terms and conditions of each transaction;
- A summary of the functions, assets, and risks of the relevant parties in relation to each related-party transaction or transaction class;
- The pricing structure and transfer pricing methodology used in relation to each related-party transaction or transaction class;
- Details of the basis on which it has been established that the arm's length principle is satisfied for each transaction or transaction class identified; and
- A financial analysis supporting the conclusions reached on the arm's length nature of each transaction or transaction class.

Typically, 30 days' notice is given in the first audit letter to provide the information requested. It is not uncommon for additional letters with further detailed queries to be issued by the auditors after the initial information request outlined above.

Comments

The manual issued by the Irish Revenue provides up-to-date clarifications regarding the compliance programs in operation in Ireland. Interestingly, the document issued may suggest that the Irish Revenue intends for the TPCR program and the transfer pricing audit program to work in tandem. Because the transfer pricing team within Irish Revenue has finite resources to undertake full transfer pricing audits, it may mean that the TPCR process will be used more going forward to risk-assess potential cases for future audits.

In today's environment, tax authorities have more information on a company's operations and global value chain. The first country-by-country (CbC) reports have been filed with Irish Revenue in early 2018, and shortly foreign tax authorities will share CbC reports with Irish Revenue through exchange of information mechanisms. In addition, many groups are now preparing their transfer pricing documentation to align with the master file and local file approach in the 2017 OECD transfer pricing guidelines, which contain enhanced information of the entire group. The increased information available to Irish Revenue on companies' operations in Ireland will assist them in assessing companies for further scrutiny in the years ahead.

— Gerard Feeney (Dublin)
Director
Deloitte Ireland
gfeeney@deloitte.ie

Kumar Das (Dublin)
Senior Manager
Deloitte Ireland
kudas@deloitte.ie

Finland makes significant changes to transfer pricing disclosure requirements

Following consultations with various stakeholders, the Finnish Tax Administration (FTA) has made significant changes to Form 78, Explanation of Transfer Prices, which is filed with the income tax return. The amended disclosure rules apply for the first time in 2018.

Below is a summary of the key changes to the amended transfer pricing form.

Who is affected by the expanded disclosure requirements?

As before the changes, the requirement to file the transfer pricing form applies to companies that are required to prepare transfer pricing documentation. A legal entity that belongs to a group of companies must prepare transfer pricing documentation if at least one of the following criteria applies:

- The group has 250 or more employees;
- The group's consolidated net sales reach EUR 50 million, and its consolidated balance sheet total exceeds EUR 43 million; or

- The group cannot be regarded as a small or medium-sized enterprise, or SME, as defined in Recommendation no 2003/361/EC of the EU Commission.

Required information

The following information regarding the activities of the local Finnish entity is required in the first section of the form:

- **Business Activities:** The local entity must choose the category or categories of industrial classifications (such as sales, manufacturing, research, services, finance, and other) that describe accurately enough the actual business operations performed. Additionally, the following information is required to be reported:
    - Whether a minimum level of profitability was determined for the local entity through arrangements made with related party/parties;
    - Whether the local entity is a party to a cost sharing agreement;
    - Whether there have been changes to the cost sharing agreement during the accounting period;
    - Whether the local entity has transferred any business activities it had previously engaged in (such as income from a certain market sector) to a related party; and
    - Whether there have been any changes in agreements concerning the local entity's business activities resulting in the realization of income and allocation of risks to another related party.
- The local entity must disclose the total marketing and R&D expenses for the accounting period (including expenses paid to related and external parties) and the compensation paid by a related party to cover these expenses (including a potential mark-up).

In the second section of the form, taxpayers are required to provide information regarding the profitability of the local Finnish entity and of the entire group based on the consolidated financials. Both EBIT and ROI-level information should be provided.

In section 3 of the form, taxpayers must report the volume of their intragroup cross-border transactions by category. The new form makes some changes to the categories, for example, regarding hedging-related income and expenses, as well as accounts receivable and accounts payable.

Section 4 covers changes in ownership of intangible property. Any intangible assets transferred as part of an asset deal must be reported in this section.

In section 5, the group's three largest loans at the end of the accounting period with at least EUR 0.5 million in interest expenses must be declared. Correspondingly, in section 6 the group's three largest receivables at the end of the accounting period amounting to at least EUR 10 million must be reported. However, accounts receivables and accounts payables are excluded in sections 5 and 6.

Penalties

The Finnish transfer pricing penalty regime is a complex set of interconnected rules. Should the FTA determine that the intercompany prices are not in accordance with the arm's length principle, and a transfer pricing adjustment is made, an additional tax increase of up to 30 percent of the added income plus penalty interest may be imposed. Additionally, a penalty of up to EUR 25,000 may be imposed if the taxpayer has not prepared sufficient transfer pricing documentation for the fiscal year in accordance with the regulations. At the moment, noncompliance with the Transfer Pricing Form 78 disclosure requirement is subject to a nominal EUR 150 tax increase, but it should be noted that the FTA links the Transfer Pricing Form related disclosure to overall transfer pricing compliance, and any inaccuracies in the disclosure increase the risk of higher transfer pricing adjustment-related penalties.

Conclusion

The purpose of the changes to the Transfer Pricing Form is to obtain broader and more accurate information regarding companies' transfer pricing. Companies should confirm consistency between the local file and the transfer pricing form.

The release of the amended detailed transfer pricing form may be seen as a sign of the Finnish Tax Administration's growing focus on transfer pricing risk analysis.

— Jari Ahonen (Helsinki)
Partner
Deloitte Finland
jari.ahonen@deloitte.fi

Hanna Viilo (Helsinki)
Partner
Deloitte Finland
hanna.viilo@deloitte.fi

Country-by-country reporting portal launched

Indonesia's Directorate General of Taxes (DGT) launched a web portal in April 2018 that seeks to consolidate country-by-country (CbC) reporting-related information in one place. The consolidated information includes CbC reporting-related provisions originally introduced by the Ministry of Finance through a regulation (PMK-213) issued in December 2016, followed by guidance on the administrative aspects of CbC reporting provided by the DGT through a regulation (PER-29) issued in December 2017. The portal also provides additional information and clarifications relating to CbC reporting, and the DGT has activated the online filing mechanism for CbC reporting notifications and CbC reports through "e-CbCR" features in the "DGP Online" platform.

The launch of the portal is timely, given the deadline of 30 April 2018 for the first cycle of CbC report/notification filings for the fiscal year ended on 31 December 2016. The clarifications provided by the DGT on the CbC reporting-related compliance requirements to date, the creation of the new CbC reporting portal, and the enabling of the online filing platform indicate a commitment on the part of the DGT to enforce compliance by taxpayers by the stipulated deadline.

The CbC reporting portal includes information on the following matters:

- List of partner countries or jurisdictions that have concluded "international agreements" (as described below) with Indonesia;
- List of partner countries or jurisdictions that have concluded qualifying competent authority agreements (QCAAs) with Indonesia (agreements between the competent authorities of Indonesia and the partner country/jurisdiction that require the automatic exchange of CbC reports between the parties);
- List of partner countries or jurisdictions that have concluded QCAAs with Indonesia, but where the CbC report cannot be obtained (due to systemic failure);
- The CbC report filing mechanism; and
- Penalties in the case of noncompliance.

This article provides a broad overview of the newly launched CbC reporting portal and details on the new information/clarifications provided by the DGT.

Background

Indonesia's CbC reporting requirements are broadly aligned with the requirements and implementing guidelines prescribed by the OECD in action 13 of the BEPS project, as well as the subsequent guidance issued by the OECD on CbC reporting.
URL: http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/transfer-pricing-documentation-and-country-by-country-reporting-action-13-2015-final-report_9789264241480-en#page1
URL: http://www.oecd.org/tax/beps
URL: http://www.oecd.org/ctp/guidance-on-the-implementation-of-country-by-country-reporting-beps-action-13.pdf

An Indonesian parent entity of a business group that has consolidated gross revenue of IDR 11 trillion or more is required to prepare and file a CbC report. An Indonesian company whose parent entity is located in another country may be required to file a CbC report if specific criteria set forth in PER-29 are fulfilled. PER-29 also introduced a requirement for Indonesian constituent entities to complete a CbC reporting notification form and submit the form to the DGT; the form requires the local taxpayer to provide a statement on whether it is obligated to submit a CbC report.

Both the notification form and the CbC report (along with "working papers" for the CbC report, which are required in certain cases) must be filed within 16 months after the end of the fiscal year for FY 2016, and within 12 months after the end of the fiscal year for FY 2017 and thereafter.

Consolidated information on CbC reporting-related compliance requirements

The CbC reporting portal provides consolidated information in relation to the compliance obligation associated with the CbC report filing requirements in Indonesia, as originally set forth in PMK-213 and PER-29. More specifically, the topics covered on the CbC reporting portal include:

- Introduction to CbC reporting;
- Introduction to QCAAs;
- Information to be included in the CbC report;
- Entities to be reported on in the CbC report;
- Local taxpayers that are obliged to file a CbC report or notification;
- Documents to be prepared and submitted as part of CbC report filing; and
- Deadlines for CbC report filing.

List of partner countries or jurisdictions that have international agreements with Indonesia

The list covers countries that have concluded tax treaties with Indonesia, signatory countries to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MCAA) and countries that have concluded tax information exchange agreements (TIEAs) with Indonesia. As of 11 April 2018, the list provided that there are 67 countries that have tax treaties with Indonesia, 115 signatory countries to the MCAA, and four countries that have TIEAs with Indonesia. The list is expected to be updated periodically.
URL: http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/the-multilateral-convention-on-mutual-administrative-assistance-in-tax-matters_9789264115606-en#.WblPEnOWzQY

List of partner countries or jurisdictions that have QCAAs with Indonesia

Indonesia has signed QCAAs with 52 countries, as provided in the CbC reporting portal; however, not all of the QCAAs may be effective from FY 2016. The CbC reporting portal breaks down the list based on QCAAs effective from FY 2016, FY 2017, and FY 2018. As of 11 April 2018, the list provided that there are 43 countries that have QCAAs effective from FY 2016, six countries that have QCAAs effective from FY 2017, and three countries that have QCAAs effective from FY 2018. The list is expected to be updated periodically.

The OECD also maintains a database of activated exchange relationships for CbC reports among countries. Now that Indonesia has its own localized database, it could be an alternate (and possibly more up-to-date) source of information on Indonesia's activated exchange relationships.
URL: http://www.oecd.org/tax/beps/country-by-country-exchange-relationships.htm

List of partner countries or jurisdictions that have QCAAs with Indonesia but the CbC report cannot be obtained

The CbC reporting portal also covers countries that have concluded QCAAs with Indonesia, but where the CbC report cannot/could not be obtained due to systemic failure. No countries have been included on this list yet, but it is expected that the list will be updated periodically.

CbC report filing mechanism

The CbC reporting portal specifically highlights that the CbC report must be filed together with the notification through DJP Online, or manually if DJP Online cannot be used.

DJP Online is a platform developed by the DGT to allow online filing of tax returns via e-filing. To access the DJP Online platform, the taxpayer must register and activate a DJP Online account. The registration requires the taxpayer to obtain an electronic filing identification number (EFIN) from the tax office.

It is pertinent to note that the CbC reporting portal explicitly mentions the requirement to file the CbC report in a "soft copy" version, *i.e.*, using the standardized electronic format of the Extensible Mark-up Language (XML) schema. Further, it notes that the CbC report cannot be filed in a "hard copy" form or any extension file other than the XML file. However, should DJP Online not be functioning, taxpayers may file the report manually. The CbC reporting portal refers to the XML Schema Definition (XSD) file developed by the OECD in preparing the CbC reporting XML Schema,

and to the OECD document "Country-by-Country Reporting XML Schema: User Guide for Tax Administrations and Taxpayers." The user guide explains the information required to be included in each data element to be reported. It also contains guidance on how to make corrections to data elements within a file. The CbC reporting portal provides a sample CbC report in the XML Schema, as well as additional guidance on filing the CbC report in the XML Schema format. The submitted XML file will be reviewed and validated by the DGT.
URL: http://www.oecd.org/tax/country-by-country-reporting-xml-schema-user-guide-for-tax-administrations-and-taxpayers.htm

The CbC reporting portal provides the XSD file for the working papers for taxpayers that are required to file CbC reporting working papers, and sample working papers in the XML Schema.

As of 12 April 2018, DJP Online has been updated and now allows for online filing of the CbC reporting notification and CbC report through the e-CbCR electronic filing platform. To enable access to e-CbCR, taxpayers must update their user profiles in DJP Online and add access to e-CbCR. Subsequently, the taxpayer's DJP Online homepage will be updated with the e-CbCR option and the taxpayer will be able to access e-CbCR.

While using e-CbCR, the taxpayer will have to go through the "Notification" stage first, in which taxpayers are required to answer certain questions that are aligned with the information required in the notification form attached to PER-29.

The CbC reporting portal confirms that the receipt generated from filing the CbC reporting notification and/or CbC reporting forms must be attached to the annual corporate income tax return for the following year.

Penalties for noncompliance

The CbC reporting portal provides detailed information on the potential penalties if the taxpayer fails to file a CbC reporting notification and/or CbC report, or fails to attach the relevant filing receipt to the corporate income tax return. The CbC reporting portal confirms that the corporate income tax return may be considered incomplete and as not being filed in such cases, and the taxpayer will be subject to a late filing penalty of IDR 1 million. In the event the taxpayer fails to file CbC reporting-related documents after being reprimanded in writing, a tax audit may be initiated. If the audit results in an adjustment, an underpaid tax assessment notice will be issued and penalties will be imposed, equal to 50 percent of the underpaid tax.

Comments

The newly launched CbC reporting portal will be a useful source of information for taxpayers that are subject to the CbC reporting requirements. It consolidates all required information in one place and facilitates easy reference to guidance for taxpayers. As an example, the list of countries having QCAAs with Indonesia will be a useful reference for taxpayers to identify situations in which they may have CbC reporting/notification filing obligations in Indonesia or other countries.

Since the information on the CbC reporting portal is expected to be updated periodically (specifically, the lists of countries mentioned above), it is important that taxpayers consider the CbC reporting portal as the key reference point for relevant information.

In terms of next steps, it is important that taxpayers take note of the following:

- Taxpayers must register themselves and activate a DJP Online account to access the DJP Online platform, if they have not yet utilized the online tax return filing mechanism;
- Taxpayers need to update their user profiles in DJP Online to enable access to e-CbCR;
- Taxpayers need to ensure that the CbC reports they prepare in the XML Schema format conform to the OECD-recommended standardized XML Schema, which has now been officially adopted and prescribed by the DGT; and
- It is important that taxpayers review and monitor the status of activated exchange relationships (the list of countries having QCAAs with Indonesia) periodically to identify situations in which they may have CbC report filing obligations in Indonesia or other countries.

— Roy David Kiantiong (Jakarta)
Partner
Deloitte Indonesia
rkiantiong@deloitte.com

Balim Balim (Jakarta)
Partner
Deloitte Indonesia
bbalim@deloitte.com

Shivaji Das (Jakarta)
Technical Advisor
Deloitte Indonesia
shivdas@deloitte.com