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In this issue:

New Zealand releases BEPS guidance to provide clarity

The New Zealand government's taxation bill to address base erosion and profit shifting (BEPS) concerns received Royal Assent on 27 June 2018, finally bringing the BEPS proposals into New Zealand's domestic legislation. The majority of the proposals apply to income years starting on or after 1 July 2018.
URL:
http://www.legislation.govt.nz/act/public/2018/0016/latest/DLM7505806.html?search=ts_act%40bill%40regulation%40deemedreg_base+erosion__25_a&p=1

While Royal Assent would normally signal the end of the road, the breadth and complexity of the BEPS changes has seen Inland Revenue release draft guidance material, in the form of five special reports, to ensure the changes are as

clear and understandable to the public as possible. This is an ambitious task, but a necessary one, and feedback is requested on the usefulness of the draft guidance (which is to be finalized and published in early 2019).
URL: https://taxpolicy.ird.govt.nz/news/2018-08-27-public-feedback-sought-draft-beps-guidance

The key areas covered by the guidance are outlined below. Some areas of the guidance will need to be clarified and refined, and other areas could benefit from further examples and direction. You can read a summary of the BEPS bill as it was reported back from Parliament and Tax alert: BEPS proposals now before New Zealand Parliament, released December 2017 on the changes as originally proposed.
URL: https://www2.deloitte.com/nz/en/pages/tax-alerts/articles/parliament-reports-back-beps-changes.html?id=us:2em:3na:als:awa:tax:100818&sfid=7011O000002Dnpk
URL: https://www2.deloitte.com/nz/en/pages/tax-alerts/articles/beps-proposals-before-nz-parliament.html?id=us:2em:3na:als:awa:tax:100818&sfid=7011O000002Dnpk

Interest limitation rules

This special report covers the new restricted transfer pricing approach, thin capitalization changes, and infrastructure project finance changes. In particular, the report covers:
URL: https://taxpolicy.ird.govt.nz/sites/default/files/2018-sr-beps-interest-limitation.pdf

- The new rules requiring related-party loans between a nonresident lender and a New Zealand-resident borrower to be priced using a restricted transfer pricing approach. The report includes a flowchart outlining the process for determining a New Zealand borrower's credit rating (i.e., whether transfer pricing rules apply, a credit rating adjustment is required, or no credit rating adjustment is required), with each step explained in detail.
- If a credit rating adjustment is required, the process for determining the rating is set out in another flowchart. The concepts of "high BEPS risk," implicit parental support, group borrower's credit rating, and long-term senior unsecured debt are also explained further.
- The new economic substance and reconstruction provisions that disregard legal form when it does not align with the actual economic substance of the transaction, or to allow transactions to be reconstructed or disregarded when the arrangements are commercially irrational and would not be entered into by third parties operating at arm's length. A flowchart is included to illustrate the overall process to be followed in determining the interest rate on a particular instrument.
- The approach required for financial institutions ("insuring or lending persons") when they are generally required to use their parent's credit rating rather than the default credit rating, restricted credit rating, or group credit rating (including a flowchart determining whether a feature can be included in pricing).
- The changes to the thin capitalization rules so that debt percentages will now be based on an entity's assets net of its "non-debt liabilities," explaining what is and what isn't a non-debt liability with examples.
- Other changes made to strengthen the thin capitalization rules, including a de minimis rule for the inbound thin capitalization rules, reducing the ability for companies owned by a group of nonresidents to use related-party debt, new rules around asset valuation, and an anti-avoidance rule for when a loan is substantially repaid just before year end.
- Amendments that have been made to provide entities carrying out eligible infrastructure projects with a limited exception from the thin capitalization rules by allowing them to claim deductions on debt that exceeds the thresholds set out in the legislation.

Transfer pricing

This special report covers the strengthening of New Zealand's transfer pricing rules, providing for closer alignment with the OECD's transfer pricing guidelines and Australia's transfer pricing rules. These changes include:
URL: https://taxpolicy.ird.govt.nz/sites/default/files/2018-sr-beps-transfer-pricing.pdf

- Extending the application of the transfer pricing rules to circumstances when there are transactions between members of nonresident owning bodies and companies and to specifically refer to cross-border related borrowings.
- Adding a reference to using the 2017 OECD transfer pricing guidelines as guidance for how the transfer pricing rules are applied, noting that any changes to the OECD guidelines will be considered with a view to updating the section YA 1 definition of the OECD guidelines to refer to the most recent version.

- Giving the economic substance of a transaction and actual conduct of the parties to the transaction priority over the terms of the legal contract, and requiring the arm's length amount of consideration to be determined using arm's length conditions. When a transfer pricing arrangement is not commercially rational because it includes unrealistic terms that unrelated parties would not be willing to agree to, the approach in the new OECD transfer pricing guidelines may apply to disregard and, if appropriate, replace the transaction.
- Placing the onus of proof on the taxpayer for providing evidence that its transfer pricing positions are correct, acknowledging that there may be a range of conditions that can be considered to be arm's length conditions. The special report endorses the three-tiered approach to transfer pricing documentation, whereby a master file, a local file, and a country-by-country report are prepared, and links to supplementary Inland Revenue guidance on what is required (in addition to the OECD transfer pricing guidelines).
- Increasing the time bar for transfer pricing positions to seven years when the Commissioner of Inland Revenue has notified the taxpayer that a tax audit or investigation has commenced within the usual four-year time bar. The example provided applies the four years from the date of filing the tax return, so the actual position will need to be clarified with officials, because the legislation and guidance are not consistent.

Permanent establishment avoidance

This special report covers the new anti-avoidance rule for large multinationals (those with over EUR 750 million turnover) that structure to avoid having a permanent establishment (PE) in New Zealand, as well as the broadening of the source rules. In particular:
URL: https://taxpolicy.ird.govt.nz/sites/default/files/2018-sr-beps-pe.pdf

- The special report explains the new PE avoidance rule that deems a nonresident to have a PE in New Zealand if a related entity carries out sales-related activities for it under an arrangement with more than a merely incidental purpose of tax avoidance (and other requirements are met). This moves away from the previous test of habitually concluding contracts and instead places the focus on whether the representative of the nonresident habitually plays a *principal role* leading to the conclusion of contracts.
- The report includes an analysis of the criteria that, if met, deems a PE to exist in New Zealand, as well as a table of examples that illustrate when the criteria are met. Also included are analysis and examples regarding whether there is a more than merely incidental purpose of tax avoidance and the consequences of this.
- The new source rules are covered, whereby if income is attributable to a PE in a country, then it will be deemed to have a New Zealand source under New Zealand's domestic rules. This is contrary to the current position, whereby to tax a nonresident on its New Zealand sales income, it is necessary to show that the income both has a New Zealand source and is attributable to a PE under an income tax treaty.

Administrative measures

This special report covers a number of the administrative changes made in relation to "large multinational groups," as newly defined in the Income Tax Act 2007 (ITA). These include:
URL: https://taxpolicy.ird.govt.nz/sites/default/files/2018-sr-beps-administrative-matters.pdf

- The increased ability of Inland Revenue to request information from large multinational groups, including the ability to impose a civil penalty of up to NZD 100,000 on multinationals that fail to respond to requests for documents. An example sets out the process by which Inland Revenue will request information held by nonresident members of large multinational groups, and the consequences of the failure to provide this information.
- The ability of Inland Revenue to collect tax owed by a nonresident member of a large multinational group from another wholly owned group member that is a New Zealand resident or that has a PE in New Zealand, and the requirement to file country-by-country reports.

Hybrid mismatch arrangements

The longest of the special reports covers the changes to introduce the OECD hybrid and branch mismatch arrangements recommendations into New Zealand domestic legislation, with modifications for the New Zealand context. As noted in the report, while the new rules are relatively complex, they will have no impact on the vast majority of taxpayers. This report covers:
URL: https://taxpolicy.ird.govt.nz/sites/default/files/2018-sr-beps-hybrids.pdf

- The rules in subpart FH addressing the hybrid and branch mismatches arising from hybrid financial instruments, disregarded hybrid payments and deemed branch payments, reverse hybrid and branch payee mismatches, deductible hybrid and branch payments resulting in double deductions, dual resident payers, and imported mismatches.
- The ability for taxpayers with inbound hybrid financial instruments to elect to treat the instrument as a share for New Zealand income tax purposes and the ability to irrevocably elect to treat a wholly owned outbound foreign hybrid entity existing on 6 December 2017 as a company for New Zealand income tax purposes. Taxpayers must send these elections to hybridelections@ird.govt.nz.
  URL: mailto:hybridelections@ird.govt.nz
- The consequential changes to the foreign investment fund (FIF) rules, nonresident withholding tax, and thin capitalization as a result of the introduction of the hybrid mismatch arrangement rules.

Deloitte comment

Taxpayers should keep in mind that we have yet to really see this legislation and guidance in force. For those entities that are affected by these rules (which is the majority of multinational taxpayers), these changes add another level of complexity and consideration to their operations. Further, even with refinement and the inclusion of more examples, the effect of these rules and their compliance burden will depend on the operational approach taken by Inland Revenue.

The majority of the new rules will become law for income years beginning on or after 1 July 2018. For companies with June balance dates, this means they effectively apply from 1 July 2018, despite the fact that the guidance on applying the rules is not likely to be finalized until early 2019.

If all that isn't enough to consider, the government has indicated that this may not be the end of the BEPS journey, and we may yet see further changes to New Zealand's international tax rules.

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OECD releases additional implementation guidance on CbC reporting

The OECD on 14 September released additional guidance on the implementation of the country-by-country (CbC) reporting requirement introduced in the BEPS Action 13 final report.
URL: https://www.oecd.org/tax/guidance-on-the-implementation-of-country-by-country-reporting-beps-action-13.pdf

The new guidance consolidates and expands on all the implementation guidance issued by the OECD since the release of the Action 13 final report. Therefore, going forward, it will only be necessary to refer to the September 2018 guidance when consulting OECD guidance on the implementation of CbC reporting.

Although OECD guidance may be helpful in understanding how countries may implement CbC reporting requirements, it is not controlling on US taxpayers unless formally adopted by the IRS. The observations below compare some of the new guidance to the current US CbC regulations.

New implementation guidance

The new implementation guidance addresses four specific issues:

- Treatment of intercompany dividends for purposes of "profit (loss) before income tax," "income tax accrued (current year)," and "income tax paid (on cash basis)" in Table 1 of the CbC report;
- The use of shortened amounts in preparing Table 1 of the CbC report;
- Reporting the number of employees when the financial data of a constituent entity is reported on a pro-rata basis; and
- Interpretation on mergers/demergers/acquisitions (summary table).

Treatment of intercompany dividends for purposes of "profit (loss) before income tax," "income tax accrued (current year)," and "income tax paid (on cash basis)" in Table 1 of the CbC report (new)

Action 13 provided clear guidance that dividends received from other constituent entities should be excluded from "revenue," but it did not provide similar guidance as to the treatment of such dividends for purposes of "profit (loss) before income tax." The September 2018 guidance addresses that absence, and provides flexibility for jurisdictions as to whether intercompany dividends should be excluded from profit/loss before tax in Table 1 of the CbC report. That flexibility is provided to avoid the compliance burdens for taxpayers that may ensue if a jurisdiction were required to change its approach.

The new guidance also states that Inclusive Framework member countries and jurisdictions are encouraged to require their taxpayers, as soon as possible and taking into account the specific domestic circumstances, to indicate in Table 3 whether intercompany dividend income or shares of earnings of another constituent entity are included in "Profit (loss) before income tax" in Table 1 and if so, for which jurisdictions.

The guidance also provides that if intercompany dividends (or similar distributions) are excluded from profit/loss before tax, then income taxes accrued and paid data should not include income taxes paid on intercompany dividends, and vice versa.

Observation: The US CbC regulations state that "revenue does not include payments received from other constituent entities that are treated as dividends in the payor's tax jurisdiction of residence."[1] While the US CbC regulations do not specifically require or permit the elimination of intercompany dividends from profit before tax, taxpayers may have excluded such dividends to be consistent with the exclusion from revenue. Under the new OECD implementation guidance, if such a consistency approach is taken, the more appropriate practice may be to also exclude any income tax paid or accrued on intercompany dividends, but the United States has not issued any specific guidance or instructions on this issue.

The use of shortened amounts in preparing Table 1 of the CbC report (new)

The September 2018 guidance clarifies that amounts in Table 1 should be reported in full whole units and should not be shortened. For example, an amount of 123,456,789 should be reported as 123,456,789 and should not be shortened, for example, to 123,457.

Reporting number of employees when the financial data of a constituent entity is reported on a pro-rata basis (new)

The implementation guidance previously clarified that for purposes of applying the EUR 750 million CbC reporting threshold, revenues of minority interest entities should be accounted for based on whether local accounting rules require proportionate consolidation in the presence of minority interests.

The September 2018 guidance adds that, when the financial data of a constituent entity is reported on a pro-rata basis, the number of employees of the constituent entity should also be reported on a pro-rata basis. Taxpayer should also note the following in Table 3 of the CbC report: "The number of employees of the constituent entity A (specified) in Jurisdiction X (specified) is reported on a pro-rata basis in accordance with the pro-rata reporting of the financial data of A."

Observation: US GAAP generally does not provide for proration of revenue in consolidated financial statements based on the existence of non-controlling interests. In addition, under US CbC reporting requirements, 100 percent of a

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[1] Treas. Reg. §1.6038-4(d)(3)(ii).

constituent entity's income is included in profit before tax even if there are minority interests held by owners outside the multinational enterprise (MNE) group. As a result, the new guidance on reporting the number of employees on a pro-rata basis when financials are reported on a pro-rata basis does not appear to be relevant for US MNEs.

Summary table on interpretation on mergers/demergers/acquisitions (new)

The September 2018 guidance added a table that summarizes previously released implementation guidance – the five sample fact patterns regarding the potential impact that mergers/demergers/acquisitions may have on determining if an MNE group's revenue exceeds the reporting threshold.

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Irish government publishes corporate tax regime roadmap

The Irish government on 5 September published a corporate tax "roadmap" that discusses the journey taken in recent years and lays out the next steps in Ireland's implementation of various commitments made through EU directives, the OECD base erosion and profit shifting (BEPS) final reports, and the recommendations set out in 2017's Coffey review.
URL: https://www2.deloitte.com/content/dam/Deloitte/ie/Documents/Tax/170912-Review-of-Irelands-Corporation-Tax-Code.pdf

The publication also flags the government's intention to hold further consultations on a range of issues dealing with complex EU Anti-Tax Avoidance Directives (ATAD) measures and recommendations from the review of Ireland's Corporation Tax regime, including transfer pricing.

Transfer pricing developments

The roadmap confirmed that legislation will be introduced in Finance Bill 2019 (circa October 2019) to update Ireland's transfer pricing rules with effect from 1 January 2020. It concludes that it is important for changes to the Irish rules to be made in a careful and considered manner as one coherent package, rather than in a piecemeal approach over a number of years. The government intends to launch a public consultation in early 2019 to allow stakeholder input on whether additional changes to Ireland's tax code are needed to ensure that the transfer pricing rules are fully effective in making sure tax is paid where value is created, and do not facilitate the transfer of profits to jurisdictions other than those where value-creating activity takes place.

The areas subject to change from 1 January 2020 are outlined in Global Transfer Pricing Alert 2017-039.
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-17-039-22-september-2017.pdf

Comments

The roadmap indicates that a period of consultation will commence in early 2019, which will provide the opportunity for affected stakeholders to interact with the Irish government regarding the proposed changes. It is likely that most, if not all, the changes proposed will be implemented into domestic law. Because the changes in domestic law will be effective from 1 January 2020, taxpayers should review their current transfer pricing arrangements, both financial and non-financial transactions, to assess their readiness to deal with the changes in a timely manner.

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Transfer pricing in Mexico – Upcoming challenges and opportunities

Mexico's President-elect and leader of the Movimiento de Regeneración Nacional Andrés Manuel López Obrador (AMLO) won the July 1, 2018, election by an unprecedented margin – around 53 percent of the total votes for president. What are the tax implications of the new government's fiscal agenda?

After the biggest election in the country's history (measured by the number of both active and effective voters and the positions open, including for president, governors, and members of Congress), AMLO and the nominated members of the cabinet are expected to continue the fiscal measures adopted by the current administration. These involve strengthening tax collection measures, especially since AMLO's so-called "Fourth Transformation Plan" includes huge social programs that will need a bigger inflow into the national treasury, among other resources. The new administration, therefore, is expected to continue to enforce the BEPS initiative measures.

The last few years have been highly dynamic in terms of transfer pricing regulations for the OECD/G20 members around the world. Mexico, an active member of both the OECD and the G20 and a leader in the Latin America region, became one of the first countries to adopt the BEPS framework into its local laws. Besides implementing the three-tiered documentation requirements into the Mexican Income Tax Law (MITL), additional rules were recently issued with regards to the local file, Annex 9 of the multiple informative return (DIM, from its Spanish acronym), and the tax report certified by the independent auditor, among other things.

Under Article 76-X and Article 110-X of the MITL, if taxpayers do not prepare and file the statutory tax report (*dictamen fiscal*) or the tax situation informative return (DISIF), they must file Annex 9 of the DIM together with their annual tax return, the deadline for which is March 31 of the following year. The DISIF should also be filed no later than March 31 and the due dates for filing the *dictamen fiscal* were left unchanged (no later than July 30 or no later than August 30 if all contributions were effectively paid by July 15 or August 15, as the case may be), allowing Annex 9 of the DIM to be filed together with such report for those taxpayers who opted to prepare the statutory tax report.

In April 2018, the Mexican tax authorities issued Rule 3.9.18 of the Miscellaneous Tax Rules, stating that taxpayers who did not have their financial statements audited for tax purposes would be allowed to file Annex 9 of DIM no later than June 30, as long as all the information included in it was consistent with that in the transfer pricing local file. Also, the transfer pricing local file could be filed with the tax authorities along with Annex 9.

Although this new rule, together with the ones already in place, could be seen as an opportunity to provide some flexibility to Mexican taxpayers for fulfilling their tax obligations, it has caused confusion among taxpayers during the first year of implementation. It is noteworthy that Annex 9 of DIM summarizes much of the information included in the local file with regards to transactions carried out with foreign related parties.

In June 2018, another major development with transfer pricing implications came into place under the Mexican Federal Tax Code – Article 69 B-Bis, which seeks to inhibit the improper transmission of tax losses. The new rule lists six clear assumptions under which the tax authorities could disallow tax losses, and three of them are closely related to transfer pricing:

- A taxpayer incurs tax losses in any of the three fiscal years following the entity's incorporation, in an amount greater than the value of its assets and when more than half of its deductions derived from transactions with related parties;
- A taxpayer incurs tax losses after the third fiscal year following the entity's incorporation, emanating from the fact that more than half of its deductions derived from transactions between related parties and when the deductions have increased by more than 50 percent in relation to its tax losses for the previous year; and

- When a taxpayer reduces by more than 50 percent its material capacity to carry out its preponderant business activity in fiscal years subsequent to that in which it declared the fiscal loss, as a result of the transfer of all or part of its assets through restructuring, splitting, or a merger of companies, or because the assets were transferred to related parties.

While the thresholds established might appear to have been set on an arbitrary basis, the Mexican tax authorities have mentioned in different public forums that this was not the case. The limit on the timing of the tax losses and the amounts of deductions were defined based on data analytics using the authorities' information technology systems and databases, which found common ground among taxpayers considered to have improperly shifted tax losses.

This new rule provides tangible proof of how transfer pricing is now being applied outside the direct legal frame of direct transfer pricing compliance obligations. Actually, transfer pricing audits are being carried out by multidisciplinary teams from the Mexican tax authorities, meaning that the audit process involves different implications besides transfer pricing for income tax purposes, including customs or value added tax. Having strong contemporaneous transfer pricing documentation in place takes on greater relevance when falling into this particular situation, because taxpayers will need to respond to the first notification issued by the tax authorities to the taxpayer within the 20 days following the issuing of the notification.

The documentation to be provided within this short time frame also includes, but is not limited to, the accounting books of the company under review for the previous 10 years, together with technical and legal arguments explaining the fiscal and legal origin and application of the tax losses.

On July 11, 2018, the second resolution of modifications to the Miscellaneous Tax Rules for fiscal year 2018 was issued by the Mexican Servicio de Administración Tributaria, introducing Rule 3.9.1.1. for transfer pricing adjustments. The rule begins by providing a definition and by classifying the different types of transfer pricing adjustments. First, adjustments can be either real – when they have both tax and financial accounting effects – or virtual – when the impact is only on taxes.

The second tier of definitions further categorize adjustments as one of the following five types:

- **Voluntary or compensatory adjustment:** Refers to adjustments made by the taxpayer itself to compensate for the difference between the controlled transfer price and an arm's length price. This would need to be made before the annual tax return for the fiscal year in which the adjustment was made is filed.
- **Primary adjustment:** Results from a tax assessment from the competent authorities for tax purposes only. A primary adjustment will create a correlative adjustment with either a domestic related party (for Mexican transfer pricing purposes, domestic transactions are also required to be at arm's length) or a foreign related party.
- **Domestic correlative adjustment:** Results from a primary adjustment for a transaction carried out with a domestic related party.
- **Foreign correlative adjustment:** An adjustment that a taxpayer resident in Mexico or a foreign resident with a permanent establishment in the country can make as a result of a primary adjustment to a foreign related party, as a consequence of (i) having applied a mutual agreement procedure contained in a tax treaty concluded by Mexico and (ii) provided that such adjustment is accepted by the Mexican tax authorities, then the Mexican related party may submit an amended annual income tax return reflecting the corresponding adjustment.
- **Secondary adjustment:** Results from the application of an assessment by the Mexican tax authorities involving a transfer pricing adjustment to certain transactions characterized as deemed dividends, e.g., interest expenses and nondeductible payments with a direct benefit to local or foreign shareholders.

Based on the definitions listed above, the rule states that taxpayers that register voluntary transfer pricing adjustments should consider adding a nominal income/increase in deductible expenses or decrease in deductible expenses, as applicable, for the monthly provisional tax calculations. The related withholding amount for income tax purposes should be paid, provisions of international tax treaties would be applicable, and the related rules for VAT and special tax on products and services (IEPS) would also be applicable.

In addition to the documentation already required for considering voluntary transfer pricing adjustments deductible for tax purposes, among other requirements, taxpayers:

- Must have filed their annual tax returns, DISIF, DIM, local file, master file, and country-by-country report (if applicable) in a timely fashion. The transfer pricing reports should include the transfer pricing adjustments applied in the fiscal year under scope and would also need to be noted in the tax returns;
- Should have a documentation report for determining the transfer pricing adjustment properly signed by the transfer pricing expert who prepared the document;
- Should have an electronic invoice with the applicable requirements; and
- Should have the documentation to prove that the applicable payments of the VAT and IEPS have been made.

Transfer pricing adjustments are a common practice within multinational companies, because many charges, specifically service charges, are initially made based on a budget, and at a certain point of the year in progress an adjustment is made to adjust the transfer pricing in order to be arm's length or to be aligned with the transfer pricing policies of the local or multinational groups. This new set of rules means taxpayers are meant to apply transfer pricing adjustments only in extraordinary situations and not as commonly practiced in the past. The exhaustive and long list of requirements and documentation to be provided to the Mexican tax authorities eliminates the flexibility of constantly changing transfer prices.

In relation to Actions 8 to 10 of the BEPS Action Plan, on July 3, 2018, the OECD released a discussion draft on the transfer pricing aspects of financial transactions. The final guidance will provide worldwide taxpayers and tax administrations with guidance and principles for financial transactions. This is of great relevance to Mexico, because transfer pricing has moved from a fiscal application and to the grounds and legal frameworks of other regulatory agencies for the local financial and economic system, such as the *Banco de Mexico* (Mexico's central bank), the *Comisión Nacional Bancaria y de Valores* (regulatory agency of the Mexican securities exchange), the *Comisión Nacional de Seguros y Fianzas* (regulatory agency for insurance and sureties entities) and *Comisión Nacional del Sistema de Ahorro para el Retiro* (regulatory agency for the pension systems).

All the financial regulatory agencies that have adopted transfer pricing rules in their legal frameworks mention that the OECD transfer pricing guidelines will provide the set of rules to establish arm's length prices among controlled transactions and entities. That said, entities that are engaged in the financial services industry involve pricing of products that can be sometimes of great complexity and that therefore involve guidance that cannot be found in the existing OECD guidelines. The Mexican tax authorities do have a special team focused on reviewing, not only the financial services industry, but also certain financial transactions carried out by multinational groups, such as hedging, cash pooling, treasury structures, intragroup loans, and guarantee fees.

In June 2018, the Mexican government approved a convention to standardize the tax treatment of income obtained by pension funds. The main objective of such conventions is to strengthen the Latin American integrated market, which is composed of the stock exchanges of Chile, Colombia, Mexico, and Peru, as part of the accords to avoid double taxation under the Pacific Alliance framework agreement. The convention establishes new limits for the member parties for taxing income and capital gains for pension funds established in the member jurisdictions and dictates that those funds will have access to the benefits provided by the agreements to avoid double taxation.

Transfer pricing has also been implemented in another local strategic economic sector – the energy sector. During the first half of Enrique Peña Nieto's (Mexico's incumbent president) term, the authorities designed and implemented a historic pack of reforms. Of those reforms, the reform of the energy sector was one that would provide Mexico with a new legal framework to enable it to become once again an energy powerhouse within the global economy. The reforms attracted foreign investment to the blocks that were awarded by the government and to the retail power market and new gas stations.

Within the complex new set of laws and rules for the energy sector, transfer pricing regulations were also implemented in the Hydrocarbons Revenues Law. Contractors performing transactions with related parties (for instance, the sale or marketing of hydrocarbons, procurement of supplies, materials or services) must establish their prices according to the transfer pricing rules established in the MITL, which make reference also to the OECD guidelines for further interpretation. In addition to the provisions mentioned above, the new contract models for exploration and production activities (such as licensing contracts, production-sharing contracts, profit-sharing contracts and service contracts) include additional considerations regarding transactions carried out with related parties. One of the annexes of the model agreements defines accounting procedures for costs, expenses, and investments. However, some specific requirements for transfer pricing purposes include:

- When a controlled transaction exceeds MXN 5 million, the operator must submit information, documentation, and evidence of the application of a transfer pricing method for determining an arm's length price for said transaction;
- Each year, each participating company must submit its externally audited financial statements, and if related-party transactions have been carried out during the year, the transfer pricing report must also be submitted; and
- All costs that are not arm's length will be rejected.

The Ministry of Finance is the competent authority for energy regulatory purposes and therefore is the entity empowered to request information and documentation from independent and related parties, regarding the transactions carried out by the contractor. The model agreement for shared production activities includes similar requirements, but the threshold for preparing and submitting a documentation report for transfer pricing purposes under the Hydrocarbons Revenues Law has been raised to MXN 20 million.

President-elect López Obrador and his team of advisors have announced that all bids around the energy sector will be put on hold to initiate a deep and thorough review of the contracts awarded to the private sector to ensure the correct application of the law. While it is uncertain what changes will be made to the regulation, the industry expects to have tighter rules in terms of compliance and transparency.

All the transfer pricing and tax regulations previously described demonstrate the Mexican state's clear commitment to the international community with regards to fighting BEPS, and also to implementing transfer pricing as a requirement for transparency and a best practice for companies doing business in certain strategic sectors of the Mexican market. Although the objectives of all these new rules are clear, many of them require adjustments, as witnessed by both local and multinational companies that have experienced in recent years added complexity regarding their compliance activities and their daily operations. In the meantime, we can continue to expect more adjustments to be issued, stronger enforcement by the tax authorities with regards to transfer pricing compliance, and the dynamic environment of a new era in international taxation.

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Aligning China's R&D arrangements and transfer pricing in a post-BEPS world

What is the appropriate structure in China for a multinational group's research and development (R&D) activities, and intellectual property (IP) ownership, to accommodate business dynamics and preserve entitlement to tax incentives, while fitting into the group's global transfer pricing arrangement in the post-BEPS era?

This question is becoming more and more important for multinational companies operating in China.

R&D activity and the ownership of IP are often core issues in multinational tax and finance considerations. In the post-BEPS era, R&D arrangements and relevant IP ownership structures are expected to come under closer transfer pricing scrutiny by tax authorities. A significant focus is the contribution of development, enhancement, maintenance, protection, and exploitation (DEMPE) functions by entities in the various jurisdictions in the value chain.

Simultaneously, many jurisdictions offer R&D incentives to multinational companies to encourage technological innovation.

There has been a gradual change in R&D activities in China, partly due to the growth of local manufacturing capability with increased accommodation to local and global needs from the demand side. This is also partly due to the Chinese government's encouragement of local R&D activities and innovation.

This change in R&D dynamics in China further complicates the set-up of transfer pricing arrangements in the post-BEPS era.

This article presents an overview of China's R&D tax incentives, its transfer pricing regime, and recent R&D developments in China. The article then presents options available to MNCs to structure their local R&D activities and IP ownership.

The article also presents a broad framework for MNCs to analyze the global, rather than Chinese, R&D arrangements and IP ownership structures.

R&D Tax Incentive and Transfer Pricing Regime

With the Chinese government's growing emphasis on and encouragement of innovation, and the 2025 national strategy of ''intellectual manufacturing,'' the Chinese tax regulations offer various tax incentives to encourage local R&D activities, including:

- High and New Technology Enterprise (HNTE) status: The local Chinese entity must retain ownership of the technology. There is a local enterprise income tax rate of 15 percent (versus the 25 percent statutory enterprise income tax rate);
- Technology Advanced Service Enterprise (TASE): The local entity's service must fall within the recognized scope, and 35 percent of its income must be from offshore outsourcing business. The local enterprise income tax rate of 15 percent applies;
- R&D expense super-deduction: For qualified R&D expenses, a 50 percent super-deduction is allowable in addition to the actual expense deduction. If the expenditures are capitalized as intangible assets, cost bases of the intangible assets will equal 150 percent of actual costs that are allowable for amortization purposes; and
- Industry-specific incentives applicable to the software and integrated circuit business.

China's transfer pricing regulations were updated in 2016 and 2017, incorporating many of the BEPS Action 13 and Actions 8-10 recommendations. The State Administration of Taxation (SAT) released new rules on contemporaneous documentation (Bulletin 42) and advance pricing arrangements (Bulletin 64) in 2016, and new rules on special tax audit adjustments and mutual agreement procedures (Bulletin 6) in 2017.

With regard specifically to intangible property considerations, China's tax authorities echo the OECD's view that intangible returns should be allocated to the entity performing the DEMPE functions, but the tax authorities also put additional emphasis on local promotion as an important IP function.

In the UN Transfer Pricing Manual, the SAT reemphasizes its attention to the topic of location-specific advantages and the local entity's contribution to the multinational entity (MNE) group's intangible property. The SAT uses an example that the local entity may not constantly pay a technology royalty to its overseas parent company for a long term (as the licensed technology value may be reduced over time), and if the local entity has developed intangibles shared with other group companies, the local entity should be entitled to a return on its intangibles. See Paragraph D.2.4.5.3, China Country Practice chapter of the UN Transfer Pricing Manual (2017).

R&D activities in China

Previously, it was more common for MNEs to characterize their China R&D operations as contract R&D, and all of the legal and economic ownership of any IP would be held by an overseas entity. This is partly because the local R&D activities are less significant and are for the most part under close direction and supervision from overseas. Depending on the specific industries and companies, our recent experience shows that now MNEs' R&D operations in China have become more diversified, and in some cases, it will be probably viewed as more than a pure contract R&D set-up.

In recent years, some MNEs' R&D global activities have been performed in a relatively decentralized manner to accommodate local market needs. For example, R&D teams from different regions, often with China as one of the hubs, now focus on different priorities with sufficient local discretion to initiate projects and R&D decisions, instead of a local R&D team following instructions primarily from its headquarters. The team in China will often exchange ideas and solutions with overseas R&D hubs or its headquarters, to their mutual benefit. Therefore, it is difficult to require strictly that all the DEMPE functions be centralized in one legal entity, when for example, the local China R&D teams play a significant role generating outcomes that benefit both the China and overseas operations.

While many MNCs traditionally prefer to have a centralized IP structure because of a clear-cut transfer pricing system, following the ''business first'' principle, it is unlikely that the tax and finance function would ask the R&D organization to make a substantial change in their work procedures. It therefore requires MNCs to explore some alternative R&D arrangement options by balancing the group's IP strategy and transfer pricing policy, against the local R&D incentives and actual business needs. In the rest of the article, we will examine feasible options.

Potential R&D and IP Ownership Structure

Contract R&D and Technology License Option: In a common arrangement, MNEs structure their China R&D as contract R&D services for the overseas IP owner and often compensate the local R&D activity via a cost plus service charge. The overseas IP owner then licenses the IP to the operational entities in China and globally, and collects a technology royalty.

While this is still a relatively common structure and it follows the centralized IP strategy, some MNEs are concerned about whether this option is sustainable in the long term, particularly if there are significant functions and DEMPE substance in the local entity.

China's SAT is very keen to understand the MNE group's overall value chain and R&D arrangement when making transfer pricing assessments. There is a potential risk that the contract R&D service relationship may be recharacterized under the view that the China entity is the economic owner of the locally developed IP by examining the local DEMPE functions.

Therefore, the contract R&D service option could be suitable for those with robust DEMPE functions in the overseas entities, and the overseas entities could excise control over the key R&D risk related to the China R&D projects. When setting up the contract R&D arrangement, MNEs would also note that the location-specific advantage is considered in the comparable analysis. Contract R&D is an area of focus for the SAT to apply the location savings argument.

However, under the contract R&D service relationship, because the China entity does not have any IP ownership, it could not qualify for China HNTE status, although under certain special arrangements in which the China entity is a pure service entity, it could assess whether it is possible to apply for TASE status.

In some cases, when the local entity does have significant DEMPE functions and contributes to the ownership of IP, MNEs may value the locally developed IP and then sell it back to the overseas owner for the purpose of achieving a globally centralized IP ownership. This is referred to as the ''valuation and sell'' option. Again, this alternative renders the local entity unable to enjoy local R&D incentives such as HNTE status.

Local Ownership Option (with Possible Cross-licensing): Many Chinese subsidiaries of MNEs performing local R&D activities consider qualifying for HNTE status to enjoy the tax incentives. If the MNE group still intends to centralize the core IP outside of China, the China HNTE status requirement will lead to a potential conflict. The prevailing China HNTE rules require that the local entity must have the IP that ''provides core support to its product/service.'' See GuoKeFaHuo [2016] No. 32.

However, from a transfer pricing perspective, an MNE's China entity often does not own the group's core IP, and the Chinese entity may still be positioned as a routine company with routine return.

To reconcile the core IP ownership required by the HNTE rules and the routine return transfer pricing policy, MNEs sometimes take the approach of categorizing the group's IPs into different levels:

- **Tier 1 IP:** The foundation of technology, normally centralized by the group-level IP owner; and
- **Tier 2 IP:** The application IPs that are developed based on the Tier 1 IP, and could be owned by local countries.

In this situation, the China entity could own the Tier 2 IP in the HNTE application. Given the ambiguity of the HNTE qualification standards and the judgment call by the government agencies involved in the review process, it is possible for the China entity to obtain HNTE status even if it does not own the group's Tier 1 IP. Meanwhile, the China entity's routine return is supported with the argument that the economic contribution of Tier 2 IP is substantially less than Tier 1 IP. In such a case, the China entity would need to make an overseas royalty payment for the use of Tier 1 IP.

This strategy seems to provide an ideal answer to MNEs in terms of enjoying the local HNTE incentive and consistently following the group's IP strategy and transfer pricing policy, if the facts and circumstances support the strategy.

However, with HNTE status, the local tax authorities often pay more attention to the transfer pricing policy. The tax authorities will probably require a higher than routine return in an actual transfer pricing audit. A robust documentation effort is required to convince the specialized SAT anti-tax-avoidance team that local IP ownership is much less valuable than the global core IP ownership, and that local Tier 2 IP ownership does not entitle the owner to a higher than routine return. *See* ''Transfer pricing considerations for companies seeking 'High and New Technology Enterprises' Status in China,'' Vol. 23 *Transfer Pricing Report* 313, June 12, 2014.

In addition, MNEs would also need to pay attention to innovation results potentially creating an impact beyond the particular jurisdiction's borders because of globalization. For example, an R&D project conducted in country A could possibly be used in country B's business, and vice versa. That is to say, the China entity might own certain IP that is used by affiliates in other countries, with the China entity also making use of the base IP that is owned by the overseas principal. In that case, it may require a complex cross-licensing agreement among the group entities with implications for withholding tax and turnover tax. These complications mean that some MNEs will be less willing to take the risk of claiming HNTE incentives even though they have local R&D activities, because it could substantiate the local IP ownership and complicate the MNE's global transfer pricing arrangement.

Cost Sharing Arrangement (CSA) Option: China's SAT introduced CSA rules in Bulletin 2 in 2009, which have not been substantially updated since the final reports on the OECD's BEPS actions were issued. However, the SAT has presented its view of IP and economic analysis in other newly released transfer pricing rules that could provide some guidance regarding China's cost sharing arrangements.

Under a CSA, a China entity would co-own the relevant locally developed IP with its overseas affiliates, while the base IP would likely be with the group IP owner. The CSA participants will share the IP development contributions based on the respective expected benefits, that is, the China entity is entitled to the sole IP usage and benefit in the China business operation, while the IP usage and benefit in the overseas operation will belong to the overseas affiliate(s).

This option could provide MNEs some flexibility for the R&D arrangement because the base IP is centralized with the group IP owner, while the China entities could perform local R&D activities based on the global base IP and with ongoing contributions from overseas. Also, the China entity and the overseas entities could make periodic adjustments (for example, on an annual basis) of contribution payments based on any update of the expected economic benefits, which could avoid the alternative complex cross-licensing arrangement. With the IP ownership under a CSA, the China entity could also apply for HNTE status and benefit from the local R&D incentive.

However, unlike the Unite States and some other countries, China does not have detailed CSA rules. It is still a relatively advanced arrangement for the China tax authorities where certain practical aspects including turnover tax and withholding tax preferential treatment need to be further clarified.

Even if a taxpayer does not need to obtain advance approval for concluding a CSA, it must submit a copy of the CSA to the tax authority for disclosure purposes. In addition, the local entity with the CSA would have to prepare and submit upon request the contemporaneous CSA special file documentation on an annual basis.

To increase certainty, MNEs may consider applying for an advance pricing agreement to increase tax certainty, although management would have to consider many other factors before making an APA application.

Overall, this option may be able to accommodate the requirements for many MNEs' global R&D arrangements and IP ownership structures. The transfer pricing arrangement under this CSA option would also require robust economic analysis because it is likely to be under the spotlight of tax authorities, but it could be advantageous given that the China entity does co-own the locally developed IP and hence maximizes the likelihood of enjoying relevant R&D incentives such as HNTE status.

Concluding Remarks

In the post-BEPS era, MNEs face increased scrutiny of their global IP structures and R&D activities.

The Chinese tax authorities have been placing great emphasis on transfer pricing involving IP with recent Bulletins No. 42, No. 64, and No. 6, which largely incorporate the BEPS recommendations.

The R&D dynamics have been changing in China with the government's strong encouragement of innovation under various incentive programs and strategic programs such as the 2025 national strategy of ''intellectual manufacturing.''

We have observed more and more local R&D activities in China by MNEs, depending on specific industries and specific business cases. This has created challenges for MNEs on how to arrange their IP ownership structures. In particular, the common centralized IP ownership structure using contract R&D service arrangements could face potential challenges while foregoing the R&D incentives. On the one hand, tax authorities cite the BEPS recommendations and new Chinese transfer pricing rules to focus on assessing the local contribution to DEMPE functions and require a share of the return attributable to the IP. On the other hand, there have been increased local R&D activities in China for business purposes.

We have analyzed the various options available to MNEs for structuring their local R&D activities and IP ownership in China. There is no perfect option available to fit all MNEs given their diversified business cases and objectives. CSAs appear to be a good option for management to address the above challenges while enjoying R&D incentives under certain scenarios. Although the rules on CSAs in China arThe not as clear as business professionals would like, we expect the Chinese tax authorities to be potentially more open to CSA arrangements and continue to relax relevant administrative requirement for CSAs in the future.

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India issues annual report on APA Program

India's Central Board of Direct Taxes (CBDT) on August 31 issued its second annual report on the Advance Pricing Agreement (APA) Program's performance for FY 2017-18. The report provides statistical data about the APA program covering six APA cycles, from FY 2012-13 to FY 2017-18, as well as a specific update on the progress made in FY 2017-18.

APA requests

According to the report, 985 APA applications were filed through March 31, 2018. The number of bilateral APA applications filed more than doubled in FY 2017-18 to 53, compared to FY 2016-17 (23). Thirty-five unilateral APA applications have been converted to bilateral. Accordingly, there is an evident shift towards bilateral APA filings, which may be attributable to the beginning of negotiations of bilateral APAs with the United States in February 2016 and India's adoption of a flexible approach to accept bilateral APAs with all its treaty partners, irrespective of the non-existence of Article 9(2) in the relevant treaty. The CBDT expects a further increase in bilateral APAs in coming years.

In addition to concluding 219 applications by March 2018, 82 cases were "disposed of" for reasons such as withdrawal of an application and merger of multiple applications. The inventory as of March 31, 2018, is 684 – 161 bilateral APAs and 523 unilateral APAs.

Sectors

Sixty-seven percent of the cases concluded belong to the services sector, followed by 19 percent in the manufacturing sector, and the remaining 14 percent in trading and other segments. In the services sector, the IT industry tops the group with a 27 percent share, followed by the banking industry at 17 percent, with the rest comprised of other industries.

Methods used

The transactional net margin method (TNMM) has been widely used; 74 percent of the cases adopted this methodology, a trend also seen in other countries. India has also used other methods, such as the profit split and the resale price methods.

Countries

Approximately 197 applications for bilateral APAs have been filed in India, of which 75 are with the United States, 45 with the UK, 25 with Japan, and the remaining with other countries. The CBDT report states that 20 bilateral APAs have been signed so far, 12 relating to the trading sector, three in manufacturing, and five in the services sectors.

Time frames

The average time to complete a unilateral APA is 32 months, and for bilateral APAs it's 42 months. But eight cases were concluded within 12 months, and 46 within 13-24 months.

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Israel publishes circulars on transfer pricing methods for distribution transactions, safe harbors

The Israeli tax authority on September 5 published two circulars on transfer pricing:

- **ITA Circular 11/2018:** Determining the appropriate transfer pricing method for distribution, marketing, and sales activities of multinational enterprises in the domestic market (the "methods circular"); and
- **ITA Circular 12/2018:** Rates and profit margins for certain transactions (the "margins circular").

The methods circular describes the appropriate transfer pricing method for multiple levels of marketing and sales activities of an Israeli entity that is part of a multinational enterprise (MNE), while the margins circular determines margins that constitute a safe harbor for several types of activity of an Israeli entity that is part of an MNE. The ITA also eased the documentation requirements in cases where the margin used in the intercompany transaction is determined in accordance with the margins circular.

The methods circular

The purpose of the circular is to describe the process of identification and analysis of intercompany activity and the most appropriate transfer pricing method for determining an arm's length share for an Israeli entity as it relates to the MNE's overall business activity. This process was designed based on experience acquired over the years though the examination of transfer pricing studies submitted to the ITA's Transfer Pricing Department of the ITA and through implementation of the relevant OECD transfer pricing guidelines.

The methods circular notes that if the functions, assets, and risks (FAR) analysis indicates that sales activity is being performed and that the local entity does not have significant intangible marketing assets, then the appropriate transfer pricing method will be the comparable profits method (CPM) and the profit level indicator (PLI) would be based on sales achieved in the market in which the local entity operates.

However, when the FAR analysis indicates that marketing and advertising activities are performed, the appropriate transfer pricing method will be the CPM, and the PLI would be based on the cost components associated with the activity itself.

The circular outlines a principle whereby, if the activity of the local entity is an integral part of the sales process, the pricing of the same activity will be derived from its purpose, i.e., its sales results. However, if the activity of a local entity does not constitute an integral part of the sale process, the pricing of the activity will be derived from a different factor.

The circular proposes to begin the functional analysis by first reviewing the Intercompany agreement between the parties, and then examining the actual functions performed by each entity to ensure alignment with the agreement.

The circular specifies criteria that help determine the nature of an activity, including identifying the entity that presents the product to the customer, characterizes the customer's needs, has the authority to make exceptional discounts or credit terms and which the customer sees as responsible for the sales.

The circular addresses three types of activity: full-fledged distribution activity, low-risk distribution activity, and marketing activity. Each type of activity possesses unique characteristics, such as:

Full-fledged distributors:

- Hold primary obligations in the transaction with the customer, not the manufacturer.
- Bear the inventory risk.
- Bear the credit and collection risk.

Low-risk distributors:

- Responsible for presenting the product and recent developments to the customer.
- Occasionally bears inventory risk and customer risk. At times these risks will be limited.
- Involved in negotiations even if it is does not sign the contract with the customer.
- Sales employees are among the highest earners in the entity and have expertise in this area of activity.
- Marketing strategy is not determined by the entity.
- Invoice generation is not necessarily done by the entity.

Marketing Activity

- Has a limited number of employees
- Employee compensation is not sales-based.
- Primarily marketing and advertising activities, as well as market research and customer segmentation activities rather than sales.
- There is another authorized dealer in the target market.

The circular states that the pricing for a full-fledged distribution activity will be derived from the sales generated by the entity rather than from its incurred costs. Common methods used to price such an activity are usually the resale price method, the CPM using a sales-based profit level indicator, or the profit split method.

The pricing method for a low-risk distribution activity will be derived from the sales generated by the entity rather than from its incurred costs. A common method used to price such an activity is the CPM using a sales-based profit level indicator.

The pricing method for a marketing activity could be derived from the entity's direct or operational expenses.

The margins circular

The purpose of the margins circular is to present the ITA's position on several types of transactions as well as simplifying the documentation and reporting requirements by providing a safe harbor regime. The margins circular allows for reporting, based on the profitability rates specified therein, that were determined based on the ITA's Transfer Pricing Department's experience. The margins circular also clarifies that the profitability rates will be examined from time to time and may be updated accordingly.

The following ranges and profitability rates meet the arm's length standard for the following transactions, as detailed in the circular.

Low value-added services: In accordance with the margins circular, services that would be considered low value-added services meet all the following criteria:

1. The services are intercompany services.
2. The services are of a supporting nature.
3. The services are not part of the core activity of the MNE.
4. The services do not require the use of unique and significant intangible assets and do not result in the creation of such assets.
5. The services do not require the service provider to bear and/or control significant risk.
6. The same services are not provided to unrelated parties.

According to the margins circular, services that cannot be considered low value-added services include research & development services, manufacturing services, or management services.

The margins circular stipulates that low value-added services will generate an operating profitability equal to 5 percent of the total related expenses.

Marketing Activity: The marketing services addressed in the margins circular are in line with the activity classified as marketing activity in section 4.3 of the methods circular.

The circular emphasizes that no unique and significant intangible assets are used for the provision of the services in the transactions to which the circular applies, and that the services do not result in the creation of such assets. In addition, the circular states that these services do not require the service provider to bear and/or control significant risk.

According to the margins circular, marketing services that meet the above criteria will generate operating profitability equal to 10 percent-12 percent of the total related expenses.

Distribution Activity: The distribution activity addressed in the margins circular is in line with the activity classified as low-risk distribution activity in section 4.2 of the methods circular that are performed in Israel.

To avoid any doubts, the margins circular states that no unique and significant intangible assets are used for the purpose of performing the activities, and the activities do not result in the creation of such assets.

In addition, the circular states that these services do not require the service provider to bear and/or control significant risk.

According to the margins circular, low-risk distribution activities that meet the above criteria will generate operating profitability equal to 3 percent-4 percent of the total revenue resulting from the sales of the local entity.

Easing of reporting requirements

The margins circular determines that a taxpayer whose reported rates are in accordance with the rates determined in the margins circular for low-value-added services, marketing activity, and distribution activity will be subject to the standard documentation requirements as detailed in section 5 of the transfer pricing regulations excluding the requirement in section 5(a)(8). In other words, the taxpayer would be exempt from detailing the components of the transfer pricing analysis conducted.

Taxpayers reporting ratios that differ from those specified in the margins circular will be subject to the standard documentation requirements as detailed in section 5 of the transfer pricing regulations.

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Cyprus’ filing deadline for revised CbC notifications is 31 December 2018

The Cyprus Tax Department on 19 September announced that any revised country-by-country (CbC) notifications that need to be filed for 2017 must be submitted by 31 December 2018 to avoid the imposition of penalties.

The CTD also announced that no CbC exchange information agreement is expected to be signed between Cyprus and the United States before 31 December 2018.

31 December 2018 is the filing deadline for the following CbC reporting obligations in Cyprus:

- Submission of CbC reports for the 2017 reporting fiscal year (for MNE groups that have a year end of 31 December 2017).
- Submission of CbC notifications for the 2018 reporting fiscal year (for MNE groups that have a year end of 31 December 2018).

CbC reporting requirement for the 2017 reporting fiscal year

CbC reporting applies to large multinational enterprise (MNE) groups with annual consolidated group revenue of EUR 750 million or more in the preceding fiscal year.

MNE groups that exceed the above threshold are required to file a CbC report that provides a breakdown of the amount of revenue, profits, taxes, and other indicators of economic activity for each tax jurisdiction in which the MNE group does business.

The obligation to file a CbC report on behalf of the MNE group generally lies with the ultimate parent entity (UPE) of the MNE group, unless a surrogate parent entity (SPE) has been appointed by the group where appropriate. The CbC report must be filed with the CTD if the UPE or SPE is resident in Cyprus.

Furthermore, when an MNE group has a Cypriot constituent entity (CE) that is not the UPE or SPE, the CE under certain circumstances may still be required to file a CbC report in Cyprus under the secondary filing mechanism. This should be considered on a case-by-case basis, as it will depend on a number of factors, including the jurisdiction in which the UPE is resident, and whether a CbC exchange relationship between Cyprus and the jurisdiction where the CbC report will be filed on behalf of the group (by the UPE or any SPE), has been activated by the deadline for filing the CbC report.

CbC reports in Cyprus are due 12 months following the end of the relevant fiscal year of the MNE group (assuming a 31 December year-end for an MNE group, the 2017 fiscal year CbC report is due 31 December 2018).

Notification requirement for 2018 reporting fiscal year

According to the Administrative Cooperation in the Field of Taxation Law, each CE of an MNE group is required to file a CbC notification in Cyprus. The notification requirement exists irrespective of the UPE’s jurisdiction of residency, or the jurisdiction(s) where a CbC report will be filed.

CbC reporting notifications in Cyprus are due on the last day of the reporting fiscal year (assuming a 31 December year-end for an MNE group, the 2018 fiscal year CbC reporting notification is due by 31 December 2018).

When a notification has been filed in Cyprus by a CE of an MNE group, based on a preliminary assessment that is no longer valid due to the continued absence of an activated exchange mechanism between Cyprus and the relevant jurisdiction (such as the United States), that notification should be revised by the end of December 2018 to avoid incurring any penalties for 2017.

Mechanism to submit the CbC report and notifications

CbC reports and notifications are filed through the Ariadni Government portal. Every CE that makes a filing must be registered with this portal for CbC purposes.
URL: https://cge.cyprus.gov.cy/re/public/

Penalties for noncompliance

A penalty of up to EUR 10,000 and EUR 5,000, in respect of each CbC report and notification, respectively, may be imposed on a Cypriot CE for late filing. Under certain circumstances, each penalty may increase up to EUR 20.000.

Taxpayers within the scope of the rules described should begin to take steps to ensure that they meet their CbC reporting obligations on time.

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Nigeria releases revised transfer pricing regulations

Nigeria's Federal Inland Revenue Service (FIRS), exercising powers conferred on it by Section 61 of the Federal Inland Revenue Service (Establishment) Act No.13 of 2007, on 27 August released revised transfer pricing regulations. The revised regulations enter into effect retroactively from 12 March 2018. The updates are the first to be made to the transfer pricing regulations in Nigeria since their introduction in 2012.

The regulations aim at increased compliance with Nigeria's transfer pricing requirements and are in line with the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* published in July 2017. The main highlights of the changes in the revised transfer pricing regulations are as follows:

	Old Regulations	**Revised Regulations**
Scope of application	The regulations gave effect to the provisions of the following legislation as they relate to connected transactions: • Personal Income Tax Act • Companies Income Tax Act • Petroleum Profits Tax Act	The scope of the regulations has been expanded to give effect to the provisions of the following legislation: • Personal Income Tax Act • Companies Income Tax Act • Petroleum Profits Tax Act • Capital Gains Tax Act • Value Added Tax Act
Materiality threshold to apply for advance pricing agreement (APA)	The materiality threshold for APA was set at NGN 50 million (approximately USD 138,000)	There is no materiality threshold
Materiality threshold for maintaining contemporaneous documentation	There was no materiality threshold	The threshold for maintaining contemporaneous documentation is set at NGN 300 million (approximately USD 832,000)
Documents required to be filed with FIRS	The following documents were required to be filed on an annual basis: • TP disclosure form • TP declaration form • Local TP documentation	A group master file is required to be filed with FIRS in addition to the documents required under the old regulations
Penalty for failure to file TP declaration form within the stipulated time period	• NGN 25,000 (approx. USD 70) for the first month of default, and • NGN 5,000 (approx. USD 14)for every month the failure continues	Penalty has been increased as follows: • NGN 10 million (approx. USD 27,000) for the first month of default, and • NGN 10,000 (approx. USD 28) for every day the failure continues

	Old Regulations	Revised Regulations
Penalties for failure to file TP disclosure form, or TP documentation within the stipulated time period	NGN 25,000 for the first month of default and NGN 5,000 for every month the failure continues	Penalty has been amended as shown below: • NGN 10 million or 1 percent of the value of controlled transaction(s) not disclosed; whichever is higher, for the first month of default, and • NGN 10,000 for every day the failure continues
Penalties for making an incorrect disclosure in the TP disclosure form submitted to FIRS	None	NGN 10 million or 1 percent of the value of controlled transactions incorrectly disclosed, whichever is higher, will apply.
Failure to provide FIRS with any information or document required within the time specified in a notice issued to the taxpayer by FIRS	None	• 1 percent of the value of each controlled transaction for which the information or document was required, in addition to; • NGN 10,000 for each day the failure continues
Failure to submit updated TP declaration form	None	• NGN 25,000 for every day the failure continues

Download the revised regulations.
URL: http://blog.deloitte.com.ng/wp-content/uploads/2018/08/Revised-TP-Regulations.pdf

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