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Australia issues guidance on transfer pricing and financing arrangements

The Australian Taxation Office (ATO) on 31 October released draft Taxation Determination TD 2018/D6, which deals with the interaction of the transfer pricing rules in Subdivision 815-B and the debt/equity rules in Division 974 of the Income Tax Assessment Act (ITAA) 1997. The previous TD that dealt with the interaction of the rules in Division 974 and the now repealed transfer pricing rules in Division 13 ITAA 1936 (TD 2008/20) was withdrawn on the same day.
URL: https://www.ato.gov.au/Business/Large-business/In-detail/Business-bulletins/Articles/Tax-Determination-TD-2018/D6/

Division 974 characterizes an arrangement as either a debt interest (on which returns generally are treated as assessable/deductible interest) or an equity interest (on which returns generally are treated as dividends) for tax purposes.

Draft TD 2018/D6 follows the same general line that was taken in TD 2008/20 and states that the transfer pricing rules will prevail over the rules in Division 974. The draft TD asks the question: Can the debt and equity rules in Division 974 of the Income Tax Assessment Act 1997 limit the operation of the transfer pricing rules in Subdivision 815-B of the Income Tax Assessment Act 1997? The ATO's answer to this question is "no."

The ATO's position is based on the fact that Subdivision 815-B explicitly states that nothing in the income tax legislation limits the operation of the transfer pricing rules. In other words, the application of the prescriptive rules in Division 974 to characterize a financing arrangement as either debt or equity for tax purposes is not necessarily the end of the matter. If the commissioner takes the view, under Subdivision 815-B, that the arrangement would have been different under arm's length conditions, then "Division 974 applies to classify the interest that arises under the scheme by reference to the arm's length conditions, not to the actual conditions."

It is important to note that Subdivision 815-B does not apply in all cases in which there are differences between the actual conditions and arm's length conditions, as the subdivision is applied only when a transfer pricing benefit, as defined, arises. Therefore, there may be instances in which Division 974 will be applied to the actual conditions, even when the arm's length conditions may be different.

Helpfully, the draft TD provides three examples that cover both inbound and outbound financing arrangements. Most pleasingly for taxpayers, example 3 describes a situation whereby an outbound interest-free loan (treated as debt under Division 974) will be treated as an equity arrangement (for transfer pricing purposes). As a result, under the transfer pricing provisions the Australian lender would not be deemed to have derived interest income. This broadly follows the approach taken in Taxation Ruling TR 92/11 (dealing with the ATO's approach under the former Division 13 ITAA 1936) whereby certain intercompany financing arrangements could be treated as "quasi-equity" and therefore not considered by the commissioner to accrue notional interest amounts. This will be especially welcome news for the energy and resources sector, where outbound arrangements such as this are common and where there has been some uncertainty since the repeal of Division 13 about how the ATO will treat these situations.
URL: https://www.ato.gov.au/law/view/document?DocID=TXR/TR9211/NAT/ATO/00001&PiT=99991231235958

There is more to come on this front, with the ATO expected to release shortly draft schedule 3 to PCG 2017/4, which will set out principles for determining whether interest-free loans made between related parties should be characterized as either debt or equity in identifying the arm's length conditions for transfer pricing purposes.

Example 1 illustrates an outbound arrangement to a distressed subsidiary that is classified by Division 974 as equity (with the returns to Australia therefore non-assessable non-exempt income), and where the application of Subdivision 815-B substitutes the actual conditions with arm's length conditions. On that basis, the draft treats the arrangement as an interest-bearing loan, therefore enabling the commissioner to use the transfer pricing provisions to deem assessable interest income to the Australian lender.

Example 2 involves a 15-year inbound arrangement where there is a discretionary interest clause. Under Division 974, this would be characterized as equity based on the actual conditions; however, the example shows the outcome when the commissioner determines that the arrangement would be debt under arm's length conditions. The focus on example 2 is on the withholding tax that would be payable on interest under the debt treatment – a reminder that reduced interest or royalty withholding tax is a transfer pricing benefit under the definition in s 815-120.

Unfortunately, there appear to be some drafting errors in the draft TD. Some aspects of the draft TD require further clarification, and the examples also raise additional questions.

In example 2, where the transfer pricing conclusion is based on interest paid from Australia to a nonresident, the draft TD flags that the commissioner may exercise his/her discretion and make a consequential adjustment to allow the Australian company a deduction for the interest amount. Unfortunately, the draft does not shed any light on how the commissioner will go about exercising his/her discretion in respect of such a consequential adjustment.

Another area that would be useful to clarify is the process the ATO will use to consider the arm's length conditions, and how these will be established and then applied. The draft currently says that the arm's length conditions assumed in the examples should not be taken as ruling on what the arm's length conditions would be. Examples 1 and 3 both involve outbound financing to wholly owned foreign subsidiaries that likely could not borrow in external debt markets; the draft concludes that the arm's length conditions in example 1 result in the arrangement being treated as an interest-bearing loan, whereas the arm's length conditions in example 3 result in the arrangement being treated as equity.

Taxpayers may wish to take the opportunity to review the terms of their cross-border financing arrangements in light of the draft TD. This will be especially important for arrangements that have features of both debt and equity, as the ATO could take a different view and seek to alter the arrangement's characterization and thus the tax treatment of the return on the arrangement.

Deloitte Australia will be making a submission to the ATO on draft TD 2018/D6, and welcomes any feedback from taxpayers who would like to contribute to this response.

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OECD's newly released MAP statistics reveal number of cases continues to rise

The OECD on 10 October issued the 2017 mutual agreement procedure (MAP) statistics, which provide detailed information regarding the MAP activities of 85 OECD and G20 jurisdictions. According to the OECD, the statistics show that even though tax administrations are closing an increasing number of cases, the total number of cases in inventory continues to rise.

Background

The final report on BEPS Action 14 (*Making Dispute Resolution Mechanisms More Effective*) includes a commitment by jurisdictions to implement a minimum standard to ensure that they resolve treaty-related disputes in a timely, effective, and efficient manner. All 115 members of the Inclusive Framework on BEPS commit to the implementation of the Action 14 minimum standard, which includes timely and complete reporting of MAP statistics pursuant to an agreed reporting framework. The 2017 MAP statistics are reported under this new framework. They cover all the members that joined the IF prior to 2018.
URL: http://www.oecd.org/tax/beps/making-dispute-resolution-mechanisms-more-effective-action-14-2015-final-report-9789264241633-en.htm
URL: http://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics-reporting-framework.pdf

Total MAP caseload

The MAP Statistics Reporting Framework makes a distinction between cases before and after 1 January 2016, which is the date in which the reporting jurisdictions committed to the implementation of the Action 14 minimum reporting standard, and between transfer pricing cases and "other cases." For jurisdictions that joined the Inclusive Framework after 31 December 2016, the distinction is made between cases received before and after 1 January of the year when the country joined the Inclusive Framework.

With that in mind, the total number of MAP cases is as follows:

All cases[1]	2017 Start inventory	Cases started in 2017	Cases closed	End inventory
Cases received prior to 1 January 2016 or of the year of joining the BEPS Inclusive Framework	6313	0	1764	4549
Cases received on or after 1 January 2016 or of the year of joining the BEPS Inclusive Framework	1187	2076	981	2282

More specifically, the number of transfer pricing cases closed in 2017, and the ending inventory is as follows:

Transfer pricing cases[2]	Start inventory	Cases started	Cases closed	End inventory
Cases received prior to 1 January 2016 or of the year of joining the BEPS Inclusive Framework	3561	0	984	2577
Cases received on or after 1 January 2016 or of the year of joining the BEPS Inclusive Framework	576	779	251	1104

Of the total number of cases in inventory – 6,831 – transfer pricing cases account for slightly more than half – 3,681. Of that total 3,681 transfer pricing cases in inventory at the end of 2017, 676 are US cases, followed closely by India with 646, Germany with 542, and France with 474.

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[1]New cases (cases received on or after 1 January 2016 or 1 January of the year of joining the BEPS Inclusive Framework) are counted using an agreed methodology that uses a common start date and allows for reconciliation of all MAP cases between members of the Inclusive Framework thus eliminating double counting. Old cases (cases received prior to 1 January 2016 or 1 January of the year of joining the BEPS Inclusive Framework) were based on each reporting jurisdictions' own methodology without a jurisdiction by jurisdiction breakdown and the possibility of reconciliation. Aggregate reporting for old cases therefore included double counting of cases reported by two reporting jurisdictions in their respective inventory.
URL: http://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics-reporting-framework.pdf

[2] New cases (cases received on or after 1 January 2016 or 1 January of the year of joining the BEPS Inclusive Framework) are counted using an agreed methodology that uses a common start date and allows for reconciliation of all MAP cases between members of the Inclusive Framework thus eliminating double counting. Old cases (cases received prior to 1 January 2016 or 1 January of the year of joining the BEPS Inclusive Framework) were based on each reporting jurisdictions' own methodology without a jurisdiction by jurisdiction breakdown and the possibility of reconciliation. Aggregate reporting for old cases therefore included double counting of cases reported by two reporting jurisdictions in their respective inventory.
URL: http://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics-reporting-framework.pdf

The aggregate statistics show a decrease in the overall number of cases in MAP inventory – from 7,500 in 2016 to 6,831 in 2017. The OECD attributes that, in significant part, to a different counting methodology used for cases received since 2016.

The individual country data shows a decrease of inventory in about half of the reporting jurisdictions and an increase in the other half. Compared to 2016, new transfer pricing cases are up by 25 percent, and other cases by 50 percent. As a result, even a 35 percent increase in the number of cases closed has not yet prevented the aggregated global inventory from rising.

The table below lists the countries that received the most new cases in 2017:

	Cases started in 2017
Germany	582
Belgium	502
UK	344
France	336
United States	299
Luxembourg	250
Netherlands	223
Italy	206
Switzerland	169
India	136

Average time to close MAP cases

The Action 14 minimum standard requires that jurisdictions seek to resolve MAP cases within an average time frame of 24 months. According to the OECD statistics, for cases that started before 1 January 2016 or 1 January of the year a jurisdiction joined the BEPS Inclusive Framework, the average time to close a MAP transfer pricing case was 40.9 months. By comparison, for cases that started on or after 1 January 2016 or 1 January of the year the jurisdiction joined the BEPS Inclusive Framework was only 7.8 months, but this statistic may be favorably affected by the small sample of cases in this group. The average time to complete a transfer pricing case in 2017 – including both pre- and post-2106 cases – was 30 months (the same as in 2016), and for other cases, 17 months.

Average times for case resolution varied significantly by jurisdiction, ranging from 3 to 59 months, and approximately 60 percent of the reporting jurisdictions met the 24-month goal across all cases.

MAP outcomes

Of the cases closed in 2017, agreement fully eliminating double taxation or fully resolving taxation not in accordance with a tax treaty was reached in 59 percent of cases. Unilateral relief was granted in 19 percent of all cases, and 4 percent of the cases were resolved through a domestic remedy. Only in 1 percent of the cases was there agreement that there was no taxation not in accordance with a tax treaty.

Timely filing of MAP requests

Competent authority assistance for double taxation is provided under the MAP article of the relevant tax treaty. To obtain relief from double taxation, competent authorities must be notified of the proposed transfer pricing adjustments, or a request for MAP assistance must be filed, within the time frames specified under tax treaties. Failure to make the appropriate filings can result in the tax authorities denying the taxpayer's request for competent authority relief to eliminate double taxation. For a more detailed discussion of the deadlines to preserve taxpayer rights to request competent authority assistance to relieve double taxation, see Global Transfer Pricing Alert 18-030.
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-18-030-7-november-2018.pdf

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Qatar implements CbC legislation

Qatar published a ministerial decision in the 9 September official gazette that introduces country-by-country reporting (CbCR) rules. Ministerial Decision No. 21 will require multinational enterprises (MNEs) with consolidated revenues of more than QAR 3 billion (approximately USD 830 million) to prepare and submit a CbC report to the Qatari Competent Authority annually. The CbCR decision will apply to financial years commencing on or after 1 January 2017.

The CbCR decision follows Qatar's signing of the base erosion and profit shifting (BEPS) Inclusive Framework in November 2017 and the Multilateral Competent Authority Agreement on the exchange of Country-by-Country Reports in December 2017. All jurisdictions that are signatories to the Inclusive Framework on BEPS must comply with four minimum standards, including those under Action 13, which requires some MNE groups to file a CbC report with financial information for all the jurisdictions in which the group has a resident entity.

The salient points of the ministerial decision are summarized below.

What is a CbC report?

The CbC reporting requirement will provide the tax authorities visibility over the global operations of MNE groups subject to the requirement. MNEs will be expected to recognize key CbCR risk areas, and possibly provide explanations for their effective tax rates, should the tax authorities inquire.

The CbC report contains aggregated information on a jurisdictional basis of an MNE's revenues, profits, taxes, stated capital, accumulated earnings, employees, and assets. The CbC report will also provide tax authorities with location and business activities of the MNE's operations.

The CbCR decision will enable the Qatari Competent Authority to assess high-level transfer pricing and other BEPS risks from the CbC report. The CbC report can also be used for economic and statistical analysis.

The CbCR decision follows CbCR legislation that has been adopted in other jurisdictions, and makes direct reference to the BEPS project. Upon initial review, it appears that there are no major differences between the Qatari CbC decision and the OECD's model CbC legislation.

Who does the CbCR decision impact?

The CbCR decision affects MNEs with consolidated revenues above QAR 3 billion that are headquartered in Qatar or have Qatari constituent entities such as subsidiaries, branches, or permanent establishments.

The CbCR decision's specified threshold of QAR 3 billion seems lower than the OECD's suggested CbC threshold of USD 850 million.

What does the CbCR decision mean for Qatari-headquartered MNEs?

Qatari-headquartered MNE groups may have been required to file a CbC report in another jurisdiction through a surrogate parent entity (SPE) for 2016. The CbCR decision will now require the CbC to be filed in Qatar, and not in the SPE's jurisdiction. This may impact CbC notifications submitted previously to various Competent Authorities, and may impose an additional burden on taxpayers due to a potential requirement to resubmit CbC notifications based on local rules.

Although there is no specific guidance on the notification process, Qatari-headquartered MNEs will be required to notify the Qatari Competent Authority to identify themselves as the ultimate parent entity (UPE). Ordinarily, the notification would be expected to be filed in advance of the financial year-end, but because the CbCR decision entered into effect after the FY17 financial year ended on 31 December 2017, the FY17 notification will be required to be submitted before 31 December 2018. Therefore, it appears that two notifications – those for FY17 and FY18 – must be submitted before 31 December 2018.

What does the CbCR decision mean for MNEs with constituent entities resident in Qatar?

MNEs with Qatari subsidiaries, branches, or permanent establishments may be required to notify the Qatari Competent Authority of the identity and residence of their UPE or SPE, if applicable, before 31 December 2018 for the FY17 and FY18 CbC reports. Consequent notifications should be made to the Qatari Competent Authority in advance of the fiscal year-end.

Notification process

The FY17 and FY18 CbC notifications must be submitted through an online form on or before 31 December 2018. The online form is not available yet, but is expected to be up and running before the aforementioned deadline.

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Thailand enacts transfer pricing law

Thailand's transfer pricing law, approved by the National Legislative Assembly in September 2018, was enacted and published in the Royal Gazette on 21 November. The new law will be effective for accounting periods commencing on or after 1 January 2019.

A summary of the new sections added to the Thai Revenue Code follows.

Section 71 bis

The new section 71 bis grants tax assessment officers the authority to adjust income and expenses for corporate income tax, cross-border withholding tax, and profit remittance tax purposes to arrive at the income and expenses as if the related companies or partnerships had operated independently (i.e. the arm's length standard).

The new section also provides a definition of related companies or partnerships.

Finally, section 71 bis specifies the prescription period for claiming a tax refund when a tax assessment officer makes a transfer pricing adjustment under this section. Tax refunds resulting from a transfer pricing adjustment can be requested within three years from the due date for filing the tax return, or within 60 days of receipt of a written notice of a transfer pricing adjustment from the tax officers.

Section 71 ter

Section 71 ter requires companies or partnerships that engage in related-party transactions to file a report (disclosure form) with their annual corporate tax return that provides information on the relationship between group entities and the value of their intercompany transactions.

Tax assessment officers, upon approval from the director-general of the Thai Revenue Department (TRD), can request that taxpayers provide their transfer pricing documentation within five years after submission of the disclosure form. The documentation will be due 180 days after receipt of an initial notification from the TRD; thereafter, the documentation will be due within 60 days, with a possible extension to 120 days upon request.

The disclosure form or transfer pricing documentation will not be required if the company or partnership has revenues that are less than an amount to be stipulated in the ministerial regulations, which should not be less than THB 200 million, or for other reasons to be specified.

Section 35 ter

Failure to file the disclosure form or transfer pricing documentation by the due date, or filing of an incomplete/incorrect disclosure form or transfer pricing documentation will result in a fine not exceeding THB 200,000.

Next steps

Supporting ministerial regulations and notifications of the director-general of the TRD, which will provide more clarity on the application of the new law, are expected to be issued soon.

Affected taxpayers should begin to take steps to ensure compliance with the new transfer pricing law. Robust contemporaneous transfer pricing documentation may serve as an efficient tool in preparing the disclosure form to be submitted with the annual corporate tax return, and it could also help taxpayers defend their positions in case of a transfer pricing audit, thus potentially reducing exposure and penalties.

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Deadlines to preserve taxpayer rights to request Competent Authority assistance to relieve double taxation under US treaties

Transfer pricing continues to be a top enforcement priority of tax authorities around the world, and one of the major risks for many multinationals. With foreign tax authorities actively asserting transfer pricing deficiencies, many taxpayers are receiving proposed adjustments regarding intercompany transactions. For this reason, it is imperative that taxpayers understand the actions required to preserve the right to request competent authority assistance to relieve double taxation.[3] Failure to do so will likely result in double taxation and impact the affected taxpayer's ASC740 calculations.

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[3] Taxpayers should be aware that tax authorities sometimes propose tax adjustments to intercompany transactions under domestic tax rules rather than under the applicable transfer pricing rules (e.g., general tax provisions that increase revenue or deny deductions). Any adjustment related to an intercompany transaction may qualify for competent authority assistance, even if the adjustment is not made pursuant to the transfer pricing rules, and the procedures in this alert should be followed to preserve taxpayers' rights to request competent authority assistance.

Competent authority assistance for double taxation is provided under the mutual agreement procedure (MAP) article of the relevant tax treaty. To obtain relief from double taxation, the United States and other countries' competent authorities must be notified of the proposed transfer pricing adjustments, or a request for MAP assistance must be filed, within specified deadlines under many US tax treaties. For example, in the case of an IRS-initiated adjustment, the foreign tax authority may require notification, and, in the case of a foreign-initiated adjustment, the IRS may need to be notified. Failure to make the appropriate filings can result in the IRS or foreign tax authority denying the taxpayer's request for competent authority relief to eliminate double taxation. In addition, taxpayers generally should not sign closing or similar agreements with the tax authorities if they intend to request competent authority assistance, because doing so may limit their ability to obtain relief from double taxation.

In 2017, the IRS received 299 new US competent authority requests, 195 relating to transfer pricing or attribution cases and 104 relating to non-transfer pricing cases.[4] Taxpayers must be vigilant regarding the tax treaty deadlines to protect their right to request competent authority assistance. These tax treaty deadlines can and do differ from domestic statutes of limitations, and taxpayers must take protective actions to keep recourse to competent authority open. The fact that the domestic statute of limitations may still be open for transfer pricing assessments in one or both of the affected countries is not determinative of the availability of competent authority assistance.

Taxpayers who are either subject to a foreign or IRS-initiated tax audit or who have a reasonable expectation that they may be subject to a foreign or IRS-initiated tax audit should review the relevant tax treaty timelines and consider taking all necessary protective measures. Taxpayers do not need to wait until the conclusion of a transfer pricing audit to take such measures.

Failure to notify the IRS (or foreign tax authority) within the specified time frames will likely preclude the taxpayer from seeking competent authority relief from double taxation, and may also give rise to issues regarding the creditability of foreign taxes.[5]

The table below summarizes the notification/filing requirements and applicable time limitations for requesting competent authority assistance between the United States and all of its current tax treaty partners. Some US tax treaties (those with Canada, Finland, Jamaica, Mexico, Netherlands, and Turkey) require notification to the tax authority that did not propose the adjustment within a certain number of years of the taxpayer's tax year-end or the filing of a tax return.

For example, the US-Mexico tax treaty requires notification to the tax authority that did not propose the adjustment within four and a half years from the due date or the date of filing of the taxpayer's tax return in the country whose tax authority did not propose the adjustment, whichever is later. The standard statute of limitations for a tax adjustment in Mexico is five years, which extends past the deadline for notification under the US-Mexico tax treaty. This could potentially lead to situations whereby the taxpayer is not aware of a tax adjustment until after the notification deadline under the US-Mexico tax treaty has passed, which could preclude the taxpayer from seeking competent authority relief from double taxation. To avoid this, taxpayers should consider filing notifications with the IRS Advance Pricing and Mutual Agreement (APMA) program at the onset of any Mexican tax examination, even if they are not certain that the examination will result in a transfer pricing adjustment.

In addition to the original notification, the IRS requires annual notification updates until a complete competent authority request has been filed. Under Rev. Proc. 2015-40, the annual notification must be submitted following the close of each taxable year ending after the taxable year in which the taxpayer submitted the treaty notification, but no later than the date on which the taxpayer timely files a tax return for such taxable year.

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[4] Organization for Economic Cooperation and Development, *United States – 2017 MAP Statistics*. Beginning with reporting year 2016, the United States reports its MAP statistics pursuant to the MAP Statistics Reporting Framework found in *BEPS Action 14 on More Effective Dispute Resolution Mechanisms*. The new reporting framework does not provide for reporting a breakdown of US-initiated adjustments vs. foreign-initiated adjustments in relation to competent authority requests received; therefore, the United States has not reported this information for 2017.
URL: http://www.oecd.org/tax/dispute/2017-MAP-Statistics-United%20States.pdf
URL: http://www.oecd.org/tax/beps/beps-action-14-on-more-effective-dispute-resolution-peer-review-documents.pdf
[5] *See Procter & Gamble Co. v. US* (S.D. Ohio, Case No. 1:08-cv-00608, defendant's motion for summary judgment granted 7/6/10).

Taxpayers should consult with their tax advisors to evaluate the relevant provisions of the applicable tax treaty and their specific application to the taxpayer's facts and circumstances.

US Treaty Partner	Notification/Action Deadline per Tax Treaty
Australia	The case must be presented within three years from the first notification of the tax authority action giving rise to taxation not in accordance with the provisions of the treaty.
Austria	No deadline.
Bangladesh	No deadline.
Barbados	No deadline.
Belgium	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Bulgaria	No deadline.
Canada	The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within six years from the end of the taxable year to which the case relates.
China	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Cyprus	No deadline.
Czech Republic	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Denmark	No deadline.
Egypt	No deadline.
Estonia	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Finland	The competent authority of the country that has been requested to provide a refund must have received notification within six years from the end of the taxable year to which the case relates.
France	The case must be presented within three years of the notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Germany	The case must be presented within four years from the notification of the assessment giving rise to double taxation or to taxation not in accordance with the provisions of the treaty.
Greece	No deadline.
Hungary	No deadline.
Iceland	No deadline.
India	The case must be presented within three years of the date of receipt of notice of the action that gives rise to taxation not in accordance with the treaty.
Indonesia	The case must be presented within three years of the first notification of the action giving rise to taxation not in accordance with the provisions of the treaty. Where a combination of decisions or actions taken in both countries results in taxation not in accordance with the provisions of the treaty, the three-year period begins to run only from the first notification of the most recent action or decision.
Ireland	No deadline.
Israel	No deadline.
Italy	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Jamaica	The taxpayer or the competent authority of the United States must give notice within the time limits established by the domestic law of Jamaica to the competent authority of Jamaica that there may be a claim for tax adjustments.
Japan	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Kazakhstan	No deadline.
Korea	No deadline.
Latvia	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.

US Treaty Partner	Notification/Action Deadline per Tax Treaty
Lithuania	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Luxembourg	No deadline.
Malta	No deadline.
Mexico	When a resident of one country presents his case to the competent authority of that country, the competent authority of the other country must have been notified of the case within four and a half years from the due date or the date of filing of the return in that other country, whichever is later. In any case arising under any article other than Article 9 (Transfer Pricing) of the treaty, it may be prudent to notify each country within four and a half years from the due date or the date of filing of the return in that other country, whichever is later. As discussed previously, the statute of limitations for a tax adjustment may extend past the due date for notification under the US-Mexico tax treaty. Taxpayers should consider filing notifications with the IRS APMA program at the onset of any Mexican tax examination.
Morocco	No deadline.
Netherlands	The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within six years from the end of the taxable year to which the case relates.
New Zealand	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Norway	No deadline.
Pakistan	No deadline.
Philippines	No general notification deadline, but there is a filing deadline with respect to the Philippines. The claim for refund or credit must be filed in the Philippines no later than two years from the close of the taxable year in which the United States imposed tax is paid, and such claim for refund or credit must be filed within five years from the close of the taxable year in issue.
Poland	No deadline.
Portugal	The case must be presented within five years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Romania	No deadline.
Russia	No deadline.
Slovakia	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Slovenia	The case must be presented within five years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
South Africa	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty (or in the case of tax collected at source, within three years from the date of collection).
Spain	The case must be presented within five years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Sri Lanka	No deadline.
Sweden	No deadline.
Switzerland	No notification deadline in Treaty; however, a formal request for competent authority assistance must be made within ten years after the final assessment of Swiss or US taxes, as applicable.
Thailand	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Trinidad and Tobago	No deadline.
Tunisia	No deadline.
Turkey	The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within five years from the end of the taxable year to which the case relates.
Ukraine	No deadline.

US Treaty Partner	Notification/Action Deadline per Tax Treaty
United Kingdom	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty or, if later, within six years from the end of the taxable year or chargeable period in respect of which that taxation is imposed or proposed.
Venezuela	No deadline; however, the statute of limitations must be "interrupted in accordance with the steps designated by domestic law" to implement the mutual agreement.

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Egypt releases updated transfer pricing guidelines

The Egyptian Tax Authority (ETA) on 23 October released an updated version of its transfer pricing guidelines, which were first issued in 2010.

The update is intended to refresh the 2010 Egyptian guidelines in light of the work conducted by the Organisation for Economic Co-operation and Development (OECD) on the base erosion and profit shifting (BEPS) project, and to provide an important source of guidance for how the ETA is likely to interpret Egyptian transfer pricing rules.

This alert provides some background to the existing transfer pricing guidance in Egypt, and examines the key changes made to the transfer pricing guidelines.

The key changes for multinational enterprises (MNEs) operating in Egypt under the updated guidelines can be classified into two categories:

- The introduction of the three-tiered approach to transfer pricing documentation (master file, local file, and country-by-country report) for the first time in Egypt effective FY2018; and
- The launching of the APA program in Egypt.

To incorporate those changes, ETA splits its published transfer pricing guidelines into two parts. Part I includes five chapters that cover:

- The arm's length principle;
- Application of the arm's length principle;
- Comparability analysis;
- Pricing methods; and
- Documentation.

Part II in its entirety is dedicated to the newly introduced APA program in Egypt. A detailed review of the changes follows below.

Transfer pricing method selection

In May 2018, the Executive Regulations to Income Tax Law No. 91 were amended to include the profit split method and the transactional net margin method (TNMM) as suitable alternatives to the main three methods (the comparable uncontrolled price method, the resale price method, and the cost plus method) and the updated transfer pricing guidelines now provide updated guidance on the use of these methods in Part 1, Chapter 4, Pricing Methods.

Previously, the 2010 transfer pricing guidelines allowed the use of transactional profit methods provided in the OECD transfer pricing guidelines when taxpayers could not reliably apply the main traditional transaction methods. Now, the updated version of the guidelines aligns with the OECD transfer pricing practice, placing all methods on an equal footing by abolishing the hierarchy of methods.

If taxpayers are unable to reliably apply any of the methods prescribed by the law, other methods can be used. However, the ETA expects taxpayers to first maintain and be prepared to provide sufficient documentation to explain why those methods cannot be reliably applied. Also, the updated guidelines contain guidance on two additional methods – the profit split method and the TNMM – and a statement on global formulary apportionment.

Risk allocation

Chapter 3 of the updated guidelines applies new guidance on a six-step process for identifying and analyzing risk in a controlled transaction, adopted from the 2017 version of the OECD transfer pricing guidelines, which incorporate the changes made under the BEPS project.

As part of the comparability analysis, taxpayers should ensure that the purported allocation of risks between associated enterprises in a controlled transaction is consistent with the economic substance of that transaction. The ETA may challenge the purported allocation of risk when it feels that the entity assuming the risks does not control or have the financial capacity to assume the risk.

Comparability analysis: localization approach

The updated guidelines recommend a hierarchical approach to the search for comparables. That is, when applying any comparables-based method, taxpayers should first limit their comparability searches to the Egyptian market. Then, if Egyptian comparables cannot be identified, taxpayers may gradually expand the geographic scope of the search to include regional comparables (within the Middle East and Africa). Finally, if Middle Eastern and African comparables cannot be located, global comparables may then be searched for.

Three-tiered approach to documentation

Starting next year, MNEs in Egypt will be required to submit (1) a local file, (2) a master file, and (3) a country-by-country report.

Taxpayers should submit both local and master files directly to the ETA's transfer pricing department. Because the master file relates to the GAE (Group of Associated Enterprises) as a whole, it should be prepared in accordance with the GAE's ultimate parent's tax return filing date; hence, it should be made available to the ETA by the taxpayer in due course. The local file should be prepared on an entity-by-entity basis, not on a group basis (that is, for two or more related taxpayers resident in Egypt for tax purposes), and is required to be submitted to the ETA's transfer pricing department two months following the due date for filing the tax return. This is a major departure from ETA's former approach of requiring documentation from taxpayers only upon request.

The thresholds for requiring a country-by-country report (CbCR) have been set out in the updated guidelines:

- Egyptian-parented groups with a foreign subsidiary/subsidiaries, with annual consolidated group revenue equal to or exceeding EGP 3 billion (approx. EUR 145 million) will be required to prepare and file a CbC report with the ETA.
- Egyptian subsidiaries of foreign-parented groups will be subject to the OECD threshold of EUR 750 million, and will be required to file a report with the jurisdiction in which the ultimate parent entity is resident.

The first CbCR should be prepared for the subject GAE's fiscal year ending 31 December 2018, and should be filed within 12 months after the closing of the GAE's 2018 fiscal year. As such, only Egyptian-parented GAEs will be required to file a CbCR with ETA.

Frequency of documentation

The ETA confirms in the updated guidelines that taxpayers should prepare their transfer pricing documentation annually to support their transfer pricing position, or update their existing transfer pricing documentation to reflect any changes in the business that will substantially impact their controlled transactions. However, in an attempt to reduce compliance burdens, the ETA relieved companies from preparing annual benchmarking by recommending that a new search should be carried out every three years. Nonetheless, the benchmarking analysis should still be updated annually, together with the company's financial information and transaction(s) in order to make sure that the arm's length principle is reliably applied.

Retaining documents and records

Taxpayers are obligated to keep records and documents for five years starting from the legal deadline for filing the transfer pricing documentation for the tax period. In some cases, it is in the taxpayer's best interest to retain transfer pricing documents beyond that period, particularly when such documents support the reliability of transfer prices established for a subsequent year, as in the case of long-term contracts.

Burden of proof

If a taxpayer fails to submit documentation within the allotted time, or submits inadequate or incorrect documentation, the taxpayer runs the risk of:

- Being designated as a high tax risk by the ETA, which would subject the taxpayer to increased risk of audit;
- Unilateral adjustment of transfer prices by the ETA; or
- Being subject to penalties determined according to the amount of the disputed annual tax base, when transfer pricing adjustments result from an audit.

APA program

The ETA has for the first time introduced an APA program in Egypt. At this time, the program is limited to accepting applications for unilateral APAs, to help taxpayers determine, in advance, the appropriate arm's length price for their controlled transactions with associated parties.

Concluding an APA with the ETA is subject to the ETA's approval of the APA request submitted by the taxpayer. The process to obtain an APA is as follows:

- The taxpayer must make a written request to the transfer pricing department within ETA for a prefiling meeting, at least six months prior to the first day of the proposed covered period.
- The ETA will provide a notification of consensus, followed by the taxpayer's submission of the APA application.
- The ETA will review the APA application and documentation package.
- The ETA will evaluate and negotiate the APA terms, followed by the taxpayer's acceptance and signing of the APA.
- The taxpayer must file an annual APA compliance report within 60 days of the tax return filing due date.

The entire process is estimated to take between three to six months.

Future work

In the updated guidelines, the ETA has committed itself to publish another set of guidelines that would address issues regarding the application of the arm's length principle to intangible property transactions, cost contribution arrangements, controlled services transactions, and attribution of profits to a permanent establishment as its subjects of scrutiny.

Comments

The updated transfer pricing guidelines provide greater clarity to taxpayers on the application of the arm's length principle, the choice of transfer pricing methods, and general compliance requirements. However, additional guidance is needed in some areas. For instance, the guidelines do not provide a mechanism for filing the local and master files; the guidance merely states that these files should be submitted directly to the ETA's transfer pricing department. Also, there are currently no materiality thresholds in respect of the local file and master file preparation requirements, which increases the compliance burden for even small-scale business operations.

Finally, the newly introduced APA regime is good news for taxpayers looking to gain certainty over the treatment of their transfer pricing methods and tax outcomes.

The ETA should provide clarity and guidance on an audit framework and dispute resolution, from planning, execution, and through to the resolution phases. Such guidance will be necessary to help MNEs and the tax administrations converge on a globally accepted set of practices that are compliant with the arm's length principle.

For taxpayers, the updated transfer pricing guidelines provide a good opportunity to review their existing transfer pricing practices to comply with the requirements of the law, to avoid a high-risk rating and increased risk of audit.

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Peru extends due date for filing CbC report for FY 2017

The Peruvian tax authority (SUNAT) has extended the deadline to submit the country-by-country (CbC) report corresponding to fiscal year 2017 for some taxpayers. Peruvian subsidiaries of foreign multinational entity (MNE) groups will have until March 2019 to file the CbC report if the MNE's parent company is required to file a CbC report in its country of residence.

SUNAT resolution

In accordance with SUNAT Resolution No. 264-2018, published on 11 November 2018, the deadline for submitting the CbC report for fiscal year 2017 is extended to March 2019, but only for taxpayers domiciled in Peru that are members of an MNE group whose parent company is not domiciled in Peru and is required to file a CbC report in its country of residence.

The CbC report – Virtual Form N° 3562 – must be filed by taxpayers subject to this requirement in accordance with the following schedule:

Last Digit of Taxpayer ID Number (RUC)	Due Date
0	14 March 2019
1	15 March 2019
2 and 3	18 March 2019
4 and 5	19 March 2019
6 and 7	20 March 2019
8 and 9	21 March 2019
Taxpayers in good standing	22 March 2019

Article 116(b)(2) of the regulations establishes the obligation to file the CbC report by those taxpayers who on the due date for filing the CbC report have a parent company domiciled or resident in a jurisdiction that has entered into an international tax treaty with Peru (or decision of the Andean Community Commission) that authorizes the exchange of tax information, but does not have a competent authority agreement for the exchange of the CbC report in force.

Given that Peru is still in the process of signing agreements for the exchange of CbC reports, under the aforementioned regulation the local taxpayer or subsidiary would be obligated to file the CbC report with SUNAT. This rule has generated significant controversy, because it is not in line with the mechanism proposed by the OECD, whereby the CbC report is filed by the MNE group's parent company in its country of residence, and the other countries access the report through the information exchange mechanism.

This extension of the deadline for submission of the CbC report for fiscal year 2017 is based on the expectation that Peru will soon sign the Unilateral Declaration of the Convention on Mutual Administrative Assistance in Tax Matters, as well as agreements between competent authorities that will allow for the automatic exchange of CbC reports.

Finally, it should be noted that the due date extension described does not apply to the filing schedule for the master file for the year 2017; thus, the master file informative affidavit must be filed as originally scheduled, on 15-23 November 2018.

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Belgium tax authorities acknowledge OECD TP guidelines and share country-specific interpretation in draft transfer pricing circular

The Belgian tax authorities on 9 November released a draft transfer pricing circular on their website. In the draft TP circular, available in Dutch and French, the Belgian tax authorities confirm that they will comply with the principles and guidance provided in the 2017 OECD transfer pricing guidelines. In addition, it is confirmed that the taxpayer can safely assume that the Belgian tax authorities will follow any future changes to the 2017 OECD TP guidelines.
URL: https://financien.belgium.be/nl/Actueel/multinationale-ondernemingen-geef-uw-mening-over-het-ontwerp-van-circulaire-verrekenprijzen

The draft circular provides a summarized overview of the 2017 OECD transfer pricing guidelines, as well as a high-level overview of the OECD guidelines on permanent establishments and some guidelines on financial transactions. Throughout the draft circular, the Belgian tax authorities provide their specific interpretation or point of view on certain topics. For example, practical guidance is provided on the application of the transactional net margin method, the profitability of routine service providers, and the limitation of which financial positions can be considered to be part of a cash pool.

The Belgian tax authorities invited interested parties to submit comments or recommendations regarding the draft circular by 12 December 2018. Deloitte Belgium will develop a position paper in response to the draft TP circular.

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Australia issues draft guidelines on inbound distribution arrangements

The Australian Taxation Office on 23 November released draft Practical Compliance Guideline (PCG) 2018/D8 on inbound distribution arrangements.
URL: https://www.ato.gov.au/law/view/document?docid=DPC/PCG2018D8/NAT/ATO/00001

The draft PCG sets out “profit markers” the ATO will use under its compliance approach to assess the transfer pricing risk of inbound distribution arrangements. The ATO provides profit markers for the following industry sectors:

- Life sciences;
- Information and communication technology (ICT);
- Motor vehicles; and
- A catch-all segment called “general distributors.”

The term “inbound distribution arrangement” is intentionally broad and is designed to cover entities that distribute goods purchased from related foreign entities for resale or distribute digital products or services where the intellectual property in those products or services is owned by related foreign entities.

As with other PCGs, the risk zones are low (green), medium (yellow), and high (red) – the higher the risk rating, the more ATO scrutiny taxpayers can expect. Being in the red zone also precludes taxpayers from requesting a prequalified unilateral advance pricing agreement (APA) process.

The ATO’s profit markers are based on earnings before interest and tax (EBIT)/sales (EBIT margin) and they are generally quite high compared to the results of our recent benchmarking experience. Taxpayers may find themselves in the “red zone,” notwithstanding the fact that their arrangements may be commercial and supported by appropriate transfer pricing documentation.

The ATO has not published, and does not intend to publish, the supporting benchmarks that have been used to determine the profit markers. The OECD’s transfer pricing guidelines state that information used by tax authorities should be publicly available so that taxpayers have an adequate opportunity to defend their own positions and to safeguard effective judicial control by the courts. We will recommend that the ATO make its benchmarks and rationale for the profit markers publicly available.

The draft PCG does not apply if the taxpayer has entered into an APA, a settlement agreement with the ATO, a court or Administrative Appeals Tribunal decision, or if the ATO has conducted a review of the inbound distribution arrangements and provided a low-risk or high-assurance rating for those arrangements.

Should taxpayers fall outside the low-risk zone, the ATO has provided a transition period of 12 months from the date of publication of the draft PCG. If during this transition period a taxpayer makes a voluntary disclosure in relation to all income years during which the arrangement was in place and adjusts the historic and prospective pricing to reflect “an appropriate transfer pricing outcome,” the Commissioner will consider remitting shortfall penalties to nil and shortfall interest charge to the base rate.

The draft PCG does not include a definition of “an appropriate transfer pricing outcome,” but given the heading of the section (*Transitioning existing arrangements to the low risk zone*), it is implied that taxpayers would need to adjust their returns to fall within the low-risk zone.

An alternative course of action for taxpayers to obtain certainty is to seek an APA, or taxpayers could choose to “document-and-defend” their arrangements by preparing transfer pricing documentation and defending their position, should it be challenged by the ATO.

It should be noted that PCGs are not ATO interpretive views of the law. While we believe taxpayers should review their transfer pricing arrangements to determine where they fall within the ATO’s risk assessment framework and consider mitigation strategies for any potential risks identified, moving towards the “green” zone may not always be necessary or appropriate.

In taking a position, taxpayers should take into consideration many factors, including global policies, the existence of robust benchmarking and transfer pricing documentation supporting preexisting arrangements, and the overall profitability of the global supply chain. Additionally, taxpayers in jurisdictions that have entered into an income tax treaty with Australia may have a supportive revenue authority on the other side of the transaction with a different view and negotiating authority in a mutual agreement procedure (MAP) context.

Disappointingly, there is a lack of symmetry between the treatment of inbound distribution arrangements (as covered in the draft PCG) and outbound distribution arrangements (as covered in the ATO's PCG on offshore marketing hubs, PCG 2017/1). We will raise this issue as part of the formal consultation process.

The ATO has also included comments in the draft PCG regarding possible disclosure of the risk zone via the Reportable Tax Position (RTP) schedule; it is likely that self-assessed risk ratings will be required on the RTP schedule in due course.

In detail

The draft PCG, like many other PCGs, seems to adopt a formulaic approach directed at influencing behavioral change by taxpayers.

Although the draft PCG makes it clear that the identified profit markers are not "safe harbors," it is possible that the ATO will start to target these returns as "quasi-benchmarks" in APAs and reviews/audits, as evidenced by the ATO's comments that arrangements in the red zone are unlikely to be settled via an APA. Comments on the interaction between the draft PCG and the APA program are provided below.

It should also be remembered that PCGs do not provide technical advice or an interpretation of the law, nor do they limit the operation of the law. The ATO acknowledges that having a low-risk rating does not necessarily mean that the transfer pricing outcomes are correct or that taxpayers have a reasonably arguable position. Similarly, having a high-risk rating under this guideline does not necessarily mean that the arrangements fail to comply with Australia's transfer pricing rules. Therefore, transfer pricing documentation supporting annual filing positions remains important, particularly for penalty protection purposes.

Moreover, looking at arrangements holistically, being in the low-risk zone from an Australian perspective could have adverse consequences on the level of risk on the other side of the transaction (for example, in a MAP situation with another revenue authority, which believes in lower distribution returns) and may not be in line with the overall group policy, thereby putting pressure on the overall supply chain.

Once finalized, the PCG will have effect from the date of publication and will apply to existing and new inbound distribution arrangements.

Risk zones

The ATO's risk zones are outlined below.

Risk zone	Relative to profit markers	ATO approach
Low	At or above profit marker A	ATO will focus on characterization, not transfer pricing outcomes. ATO open to early engagement APA discussions, and more likely to invite taxpayers to make a formal APA application. Taxpayers are eligible to request a prequalified unilateral APA process
Medium	Below profit marker A, but at or above profit marker B	ATO will monitor arrangements and may discuss with taxpayer before deciding to allocate further compliance resources. ATO open to early engagement APA discussions and may invite taxpayers to make a formal APA application. Taxpayers are eligible to request a prequalified unilateral APA process (but prior year outcomes may be reviewed)

Risk zone	Relative to profit markers	ATO approach
High	Below profit marker B	ATO will consider appropriate treatment options and recommend that taxpayers review their transfer pricing policy. ATO may: • Write to taxpayers to express its concern; • Actively monitor the arrangement; or • Commence a review or audit. ATO will take into account additional factors, including the global supply chain, the tax profile of related parties, and the amount of tax at risk. ATO considers that consistent loss makers pose a very high transfer pricing risk and will prioritize cases in which taxpayers are in an overall loss position for the aggregate of the current and previous two income years. Taxpayers may seek early engagement APA discussions, but they will not be eligible to request a prequalified unilateral APA process.

Profit markers

The ATO has undertaken various benchmarking exercises to understand the relevant profit margins earned by independent distributors pertinent to the Australian economy. We understand the ATO has used both Australian and foreign companies in its analysis; however, as with earlier PCGs, it does not intend to publish its benchmarking analyses. We will advocate for the underlying information that has informed these profit markers to be made publicly available.

The financial ratio the ATO uses for its profit markers is earnings before interest and tax (EBIT) relative to sales (that is, the EBIT margin), commonly referred to as an operating margin. The ATO considers that the EBIT margin provides a reasonable basis for it to identify transfer pricing risks for *inbound* distribution arrangements. It should be noted that this ratio differs from the ratio used by the ATO to risk rate *outbound* distributors, where a net cost plus (NCP) method, or Berry ratio, is the gauge. In most cases, an EBIT/sales ratio will lead to a higher rate of profits for a distributor, meaning that the ATO's expectation is that inbound distributors with ostensibly the same characteristics as outbound distributors are expected to achieve higher returns. The apparent anomalies in this position are not dealt with in the draft PCG, and this asymmetry is disappointing.

For example, the ATO acknowledges in PCG 2018/D8 that when inbound distributors undertake more economically significant functions relative to the generation of overall value, they would be expected to earn a relatively higher profit (that is, a higher EBIT/operating margin). The ATO also mentions taking into account whether the inbound distributors are significantly developing, enhancing, maintaining, protecting, or exploiting intangibles when assessing risk. Unfortunately, such an acknowledgment (about value-add functions and contributions to intangibles driving higher returns) was not present in PCG 2017/1 in the context of outbound arrangements.

The EBIT margins used by taxpayers should be the margins related to the inbound distribution arrangement only, with revenues and costs of any other business activities being carried on to be excluded from the calculation. The ATO acknowledges that determining the significance of unrelated revenues and costs to the risk assessment process is a matter of judgment. While providing different profit markers for different industries is useful, it may be challenging and burdensome for taxpayers to self-assess which particular category they fall into.

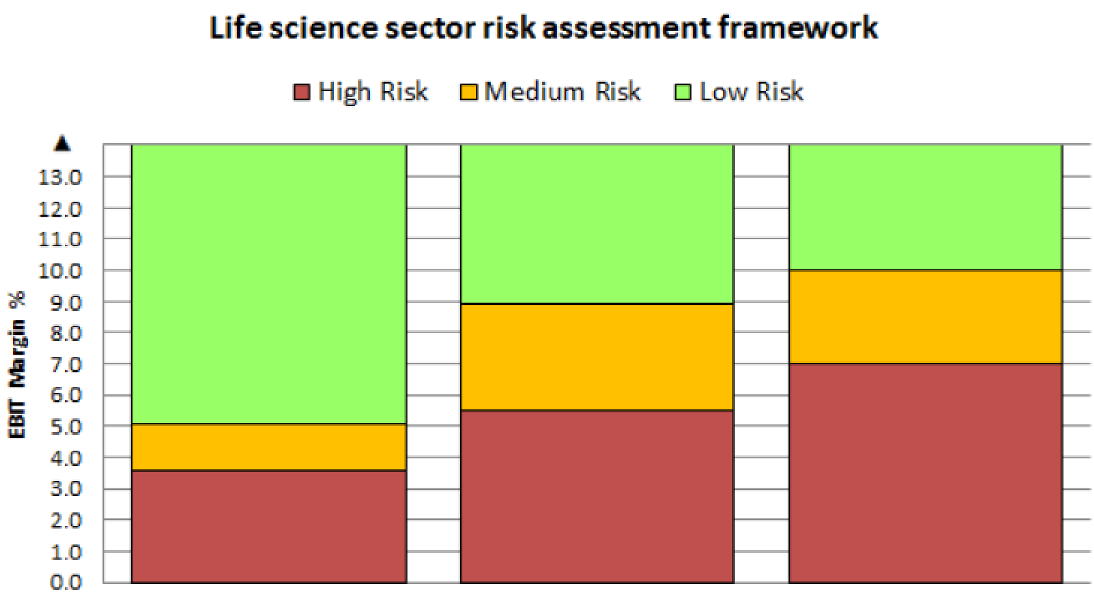
The profit markers per industry sector are outlined below.

Life sciences

The life sciences industry consists of entities involved in the discovery, development, production and sales, and marketing of medicine. The ATO has identified three subcategories within the life sciences industry, reflecting increasing levels of activities that incrementally generate value:

1. Distribution of life science products, including detailing and marketing and logistics and warehousing;
2. Activities in item 1 above, plus regulatory approval, market access, or government reimbursement activities; and
3. Activities in items 1 and 2, plus specialized technical services.

The ATO's identified profit markers and risk zones per category are detailed below.



	Category 1	Category 2	Category 3
High risk	Below 3.6	Below 5.5%	Below 7%
Medium risk	Between 3.6% - 5.1%	Between 5.5% - 8.9%	Between 7% - 10%
Low risk	Above 5.1%	Above 8.9%	Above 10%

Per the ATO's definitions, a taxpayer is either a "distributor" or a "distributor-plus." However, some distributors do not perform certain key functions; a classic example is outsourced warehousing/logistics. For example, a company may provide technical services (for example, training on how to use products), but it may not be responsible for obtaining regulatory approvals nor undertake warehousing. The PCG methodology would place this company in Category 3, but looking at the company in a balanced way, there could arguably be some modification for functions not performed. Thus, a company might self-assess itself into a higher risk category than it should be in when the company's functional profile is considered in a balanced and holistic way. This may lead to inappropriate risk-rating outcomes.

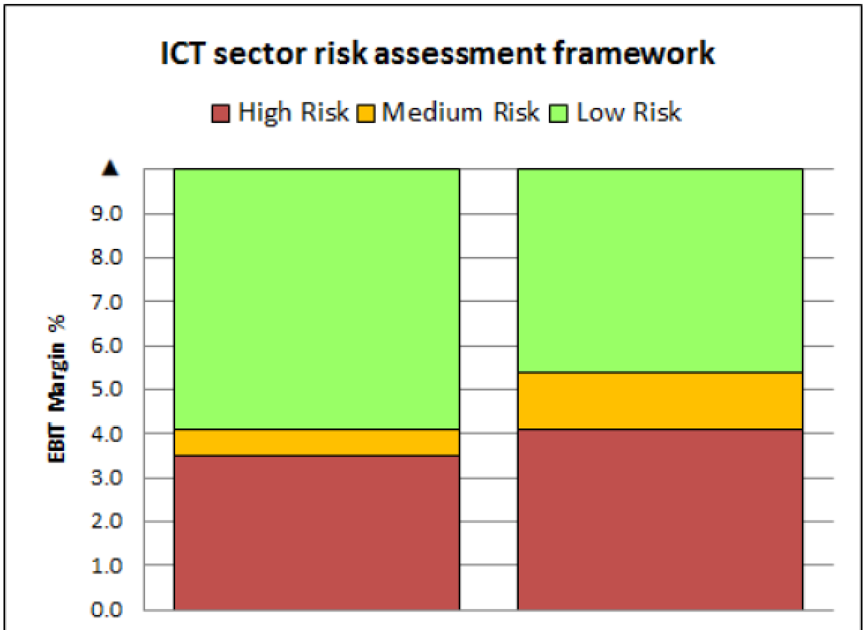
Information and communication technology

The ICT industry sector includes all types of consumer and enterprise computer hardware and software products, digital communication devices, applications, IT solutions, and ancillary services that enable interaction through technology.

As with the life sciences sector, the ATO has identified two subcategories, reflecting increasing levels of activities that incrementally generate value:

1. Distribution of ICT products, including sales and marketing, pre- and/or post-sales services and logistics and warehousing; and
2. Activities in item 1 above, plus complex sales processes, direct selling activities, and/or large customer relationship management.

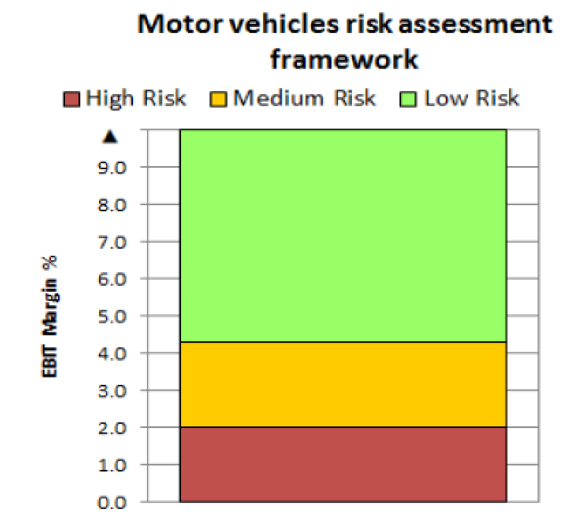
The ATO's identified profit markers and risk zones per category are detailed below.



	Category 1	Category 2
High risk	Below 3.5%	Below 4.1%
Medium risk	Between 3.5% - 4.1%	Between 4.1% - 5.4%
Low risk	Above 4.1%	Above 5.4%

Motor vehicles

The ATO considers entities to be in the motor vehicles industry sector if their business trades in passenger vehicles, trucks, buses, motorcycles, or other recreational motorized vehicles or their associated parts. The ATO provides commentary on the motor vehicle industry, and states that the role of a motor vehicle distributor includes a range of functions that support the activity of distribution, including marketing and sales, after-sales support, procurement and administration, insurance activities, as well as functions involving transportation, warehousing and inventory management. Motor vehicle distributors are assessed as a single category based on one set of profit markers, which is outlined below.

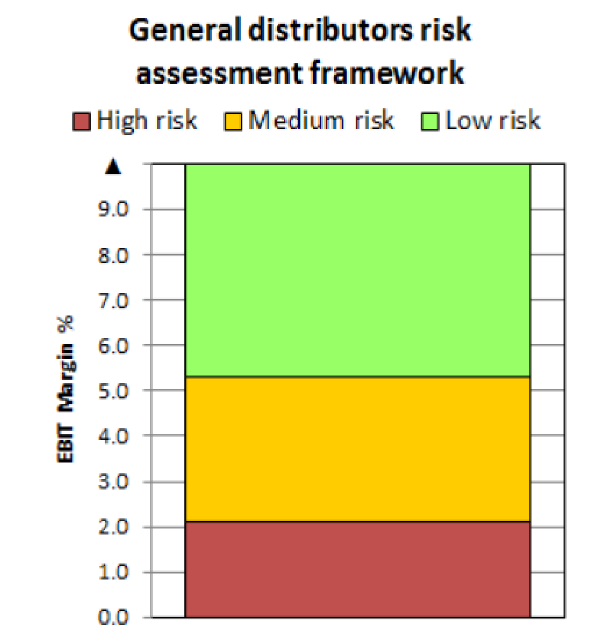


High risk	Below 2%
Medium risk	Between 2% - 4.3%
Low risk	Above 4.3%

General distributors

The general distributors category is a broad category that covers a wide range of industries and circumstances. As such, the ATO has not specifically identified categories of activities; rather, transfer pricing risk for general distributors is assessed as a single category based on one set of profit markers. The ATO does comment, however, that it expects entities performing more activities to have a higher profit. It should be noted though that, based on the OECD transfer pricing guidelines, while more functions/risks can lead to higher profits, they may also lead to an entity incurring losses.

The ATO's identified profit markers and risk zones for general distributors are detailed below.



High risk	Below 2.1%
Medium risk	Between 2.1% - 5.3%
Low risk	Above 5.3%

Interaction with APAs

As mentioned above, the draft PCG will not apply to taxpayers with an APA, a settlement agreement with the ATO, a court or Administrative Appeals Tribunal decision, or those with inbound distribution arrangements previously reviewed by the ATO and attributed low-risk or high-assurance ratings.

PCG 2018/D8 provides lengthy commentary on how taxpayers can obtain certainty via an APA. However, the ATO states that when taxpayers are in the high-risk zone (and are expected to stay there), there are likely to be factors that would make it difficult to reach an agreement under the APA program.

The ATO also comments in the draft PCG that significant divergence between EBIT and profit before tax (PBT) will require particular attention, given the ATO's assertion that inbound distributors are not expected to enter into significant debt arrangements.

The draft PCG includes commentary on a prequalified APA process. The APA application needs to align with the profit markers in the draft PCG (although it is not clear whether this means taxpayers should fall within the low-risk zone or simply fall outside the high-risk zone). The prequalified APA process means there is reduced information gathering, focusing on confirming:

1. The appropriate characterization as an inbound distribution arrangement and
2. The applicability of the transactional net margin method (once confirmed, this eliminates the need to prepare benchmarking).

Prequalified APAs will still go through the ATO's triage process (outlined in PSLA 2015/4).

Transactions covered by an APA (including prequalified APAs) entered into after 4 April 2017 will be considered low risk for purposes of the diverted profits tax (DPT). However, taxpayers should note their desire to have DPT sign-off in the APA submission (or as early as possible) to enable the ATO to gather sufficient information to make a decision on the request.

Next steps

Taxpayers who may be affected by the draft PCG should consider reviewing their arrangements against the formulaic ATO risk assessment framework.

Based on a preliminary assessment, it may be appropriate to approach the ATO to obtain certainty. As outlined above, taxpayers can:

- Transition to the low-risk zone;
- Apply for an APA; or
- Document-and-defend their position.

Before deciding on a particular course of action, taxpayers should consider all relevant factors, including global policies, existence of robust benchmarking and transfer pricing documentation supporting preexisting arrangements, the overall profitability of the global supply chain, and the likely action of the revenue authority on the other side of the transaction.

The ATO has requested that comments be provided by 21 December 2018. Deloitte will be making a submission and we welcome comments for inclusion.

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Danish court rejects tax authority’s proposed adjustment in MNE group restructuring

The Danish National Tax Tribunal (NTT) published a ruling on 8 October regarding whether the Danish tax authorities (SKAT) were allowed to perform a discretionary assessment to deem an intercompany compensation charge in relation to the closure of a Danish company as a result of a European group restructuring.

The case – SKM2018.510.LSR – involved a Danish subsidiary of a large foreign-based multinational group. The group decided to close down the Danish subsidiary’s production activities as part of a broader international turnaround plan.

SKAT took the position on audit that a compensation charge based on a discretionary assessment that resulted in an increase in the Danish company’s taxable income was appropriate. SKAT justified the adjustment by arguing that only the remaining part of the group benefitted from the closure of the Danish production activities. SKAT also argued that had the closure taken place between two unrelated parties, the multinational group would have had to pay the Danish subsidiary compensation for the costs incurred in relation to the closure.

Although the Danish company was obligated to prepare transfer pricing documentation, the documentation did not include a description of a compensation charge or of the restructuring within the group. Referencing the Danish statutory order on transfer pricing documentation that was in effect from 2006, SKAT argued that it was allowed to perform a discretionary assessment because no description of a compensation charge or the restructuring was included in the Danish company's transfer pricing documentation. SKAT performed the discretionary assessment by deeming a compensation charge to the Danish company that equaled the costs related to the closure of the production activities.

The Danish company argued that SKAT's adjustment should be rejected, because the group restructuring did not involve any controlled transactions (including any transfer of assets to related parties) with the Danish company.

Legal basis

The NTT concluded that SKAT did not have a legal basis to perform a discretionary assessment of the company's taxable income, because the formal content requirements for Danish transfer pricing documentation were not in effect for the years under audit. Hence, the Danish company was not obligated to include information on the restructuring in its transfer pricing documentation, and SKAT could not use the lack of information to justify a discretionary assessment of the Danish subsidiary's taxable income.

Transfer of assets

The NTT referred to chapter 9, part II, section D the OECD's 2010 transfer pricing guidelines to emphasize that SKAT had not proved that any transfers of assets such as machinery or customer lists had taken place between the Danish company and its related parties in relation to the closure of the production activities in Denmark.

The NTT also emphasized the fact that demand for production depended to a large extent on price, not trademarks or reputation. Furthermore, the other production subsidiaries within the group already served the same clients as the Danish subsidiary; thus, those customer relationships already existed before the closure of the Danish company.

For the NTT, both these facts supported the conclusion that no transfer of assets had taken place.

Contractual relationship

Referring to part II, section E of the OCED's 2010 transfer pricing guidelines, the NTT concluded that SKAT could not prove that the contractual relationship between the Danish company and the group should justify compensation of the costs related to the closure of the Danish production activities. After assessing the characteristics of the production and the factory, the NTT concluded that unrelated parties would not have secured their investment risk by agreeing to a compensation charge.

Territorial restriction on sale of production equipment

As a result of the closure of the Danish operation, the Danish company sold its production machinery to unrelated parties. However, the group decided that the production machinery should be sold outside of Europe to avoid a sale to direct competitors.

SKAT argued that this restriction could have a negative effect on the realized price paid for the machinery, and that such a group decision benefited other group companies and hence the Danish company should be compensated for this.

The NTT concluded that the territorial restrictions decided at group level had no effect on the actual realized price, because the Danish production capacity amounted to less than 1 percent of the total production on the European market; thus, no group companies benefited from the territorial restrictions.

Conclusion

The NTT ruling illustrates the point that SKAT's positions based on discretionary assessments should be carefully reviewed before accepting the decision, particularly if those decisions include "deemed" transactions.

The ruling also illustrates the importance of solid transfer pricing documentation. Although in this particular case SKAT was denied the ability to perform a discretionary assessment, an important factor in this result was the fact that the

Danish content requirements for transfer pricing documentation were not in effect for the years under audit. However, Denmark currently has substantial content requirements for transfer pricing documentation.

Finally, it seems clear that when SKAT has deemed a transaction (for example, a transfer of assets such as customer lists or other intangibles) and the taxpayer has prepared adequate transfer pricing documentation, SKAT must document that a transfer has actually taken place.

SKAT may still appeal the NTT ruling to the Danish civil courts. The deadline to file an appeal is three months from the date of the ruling, so the ruling must be appealed by early December.

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Clear, well-defined intercompany contracts provide significant benefits in the post-BEPS world

In the post-BEPS world, intercompany contracts play a significant role in demonstrating compliance with the Organization of Economic Cooperation and Development's transfer pricing guidelines (TPG). A well-drafted intercompany contract will be seen by many tax authorities as an important initial indication that the company has a well-thought-out transfer pricing policy that considers the important drivers of transfer pricing results. The absence of well-drafted intercompany agreements may leave the opposite impression.

Under the post-BEPS TPG, tax authorities will focus on the accurate delineation of the transaction. The concept of "delineation of the transaction" involves understanding the parties' actual activities through a detailed functional and risk analysis. Contracts are the starting point that provide the allocation of functions and risks to be undertaken by the parties. Without a clear contract, tax authorities may "complete" the contract as they believe it should be completed, allocating risk (and return) to the party in their own jurisdiction or another jurisdiction based on their subjective determinations. By identifying, allocating, and specifically addressing how – and by which party – each economically significant risk will be controlled and managed, companies may be in a better position to begin the discussion with tax authorities.

Although a well-thought-out contract is important, companies should expect tax authorities to examine whether the commercial arrangement reflected in the contract substantially conforms to the conduct of the parties. Conduct will ultimately determine the commercial and financial relations between the parties to a controlled transaction. A well-drafted contract can be a reference point for operational management that defines the parties' roles and expectations, which may make it more likely that conduct will be in alignment with management's transfer pricing policies.

Under the post-BEPS TPG, selection of a transfer pricing method such as the transactional net margin method/comparable profits method or cost plus will no longer drive the allocation of risk or the outcomes attributable to risk assumption. Rather, the management, control, and funding of economically significant risks will be important determinants of which party is entitled to financial returns attributable to risk outcomes. The management and control of risk are the functions of assessing and responding to risk associated with commercial activity. The TPG state that intercompany contracts not only provide the starting point for delineating the transaction between the parties, but also indicate how the parties intended to divide the management and control responsibilities of those important risks, and the financial returns from the anticipated outcomes at the time of entering into the contract, before the outcome of the risks was known.

In intercompany transactions, it is not unusual for one entity to perform overall risk management and control and for another entity to perform day-to-day risk management activities. The TPG provide that the entity performing overall risk management may outsource control over day-to-day risk mitigation without losing control of those activities if the outsourcing party controls the outsourced day-to-day activity. In many situations, establishing which party controls overall risk management and which party controls day-to-day activity will be an important indicator of which party is entitled to the financial returns from a transaction. A contract can provide important evidence of the parties' intent with respect to overall risk management and overall control of outsourced day-to-day activities.

Examples

The following examples present circumstances when a clearly defined contractual allocation of functions and risks can impact the allocation of transfer pricing returns.

Example 1: Contract Manufacturing Scenario 1: Company A enters into a contract manufacturing agreement with Company B. Under the contract, Company A provides product specifications and designs, and specifies objectives of quality control standards. Company B supplies products as per specifications and in accordance with the quality control standards. Company B invoices Company A on an agreed upon cost plus basis. Company A enters into a separate contract with Company C to perform regular quality control of the manufacturing process and the product specifications. Company C performs quality control of Company B's activities on behalf of Company A.

How do we analyze this fact pattern under the new BEPS guidance? First, what are the economically significant risks? The operationally significant risks are determined to be product recall risk and inventory risk. Second, who controls those risks? Company A controls its product recall and inventory risks by exercising its capability and authority to take on the risk and responding to the risks. In addition, Company A has the capability to assess and make decisions relating to the risk-mitigation functions, and actually performs those functions. These include determining the objectives of the outsourced activities, the decision to hire the particular manufacturer and the party performing the quality checks, the assessment of whether the objectives are adequately met, and, when necessary, to decide to adapt or terminate the contracts. Those are all issues that would be defined in the contract between Company A and Company B and the contract between Company A and Company C to clarify that Company A is controlling all of those risks.

Example 2: Contract Manufacturing Scenario 2: Same facts as in Scenario 1, except that Company A only provides Company B with product specifications and designs. Company A does not hire Company C to perform quality control procedures. Company B determines processes to manufacture the product, Company A relies on Company B's qualified personnel to determine the quality control procedures and to perform the quality control activities, and Company A does not have sufficient qualified personnel to oversee Company B's activities.

Does Company A control the product recall risk? Company A appears to control product recall risk with respect to the design of the product, because it is engaged in designing the product and provides the designs and specifications to Company B. Although Company A chose Company B to perform the manufacturing and quality control activity and can fire Company B, it is unclear whether these factors alone would be sufficient to demonstrate control over the manufacturing and quality control processes and procedures. Company B may be found to control the product recall risk with respect to manufacturing because it determines the manufacturing processes and quality control procedures with respect to those processes, and performs the quality control functions. The fact that in the contract between Company A and Company B Company A has agreed to provide Company B a cost plus return may not be sufficient to show that the entire product recall risk should be allocated to Company A.

Example 3: R&D Services Scenario 1: Company A has a contract development arrangement with Company B. Company A decides to perform part of the development work itself and decides to seek specialist input (from Company B) for part of the development process. Under the contract, Company A is entitled to decide what type of researcher(s) in Company B will work on the projects, the specific objectives of the research, as well as the budget allocated to Company B to perform the research. Company B is required under the contract to report back to Company A at predetermined milestones. These reports enable Company A to assess the progress of the development and decide whether its ongoing objectives are being met, and whether to continue investments in the project in light of that assessment. Company A has the financial capacity to assume the risk. Under these facts, it will likely be concluded that Company A controls the development risk. Because the rights and obligations are clearly defined in the contract, the tax authorities are only required to test whether the parties' actions conformed to the defined terms. Without a contract, tax authorities could engage in a more extensive analysis of the parties' activities.

Example 4: R&D Services, Scenario 2: Same facts as in Example 3, but Company A only provides Company B with the objectives of the research and the expected budget. Company B's qualified personnel determine the type of researchers assigned to the project, and the approach to accomplish the development objectives. Company B reviews the results of the project on a weekly basis and adjusts the approach to meet the development objectives based on the results. Company B is in contact with Company A on progress, but there are no predetermined milestones and Company A relies on Company B's qualified personnel to determine whether the ongoing objectives are being met.

Does Company A control the development risk? Tax authorities may argue that Company A controls only the financial risk, but does not control the development risk. Although Company A determines the overall objectives of the project and hired and can fire Company B, this level of control may only support Company A's control of the financial risk. Company B, rather than Company A, determines the type of researchers assigned to the project, and the approach to accomplish the development objectives. Company B, rather than Company A, reviews the results of the project on a weekly basis and adjusts the approach to meet the development objectives based on the results. Finally, Company A's reliance on Company B to accomplish the goals with little if any monitoring may suggest that Company B is in control of the development process. The fact that in the contract Company A has agreed to reimburse Company B for the cost of the development activity plus an arm's length mark-up may not support a conclusion that Company A controls the development risk.

Action 13 local file requirements

OECD action 13 guidance requires that a position be taken on the contractual terms of each transaction. The OECD local file requires:

1. A description of the contractual terms of the transaction; and
2. Results of the analysis of the six-step process to accurately delineate the management, control, and funding of risk; and
3. Copies of intercompany agreements.

Thus, for purposes of action 13 local file compliance, a comprehensive contract is recommended.

BEPS contract analysis process: In conducting a BEPS contract analysis process, the following steps may be considered to identify potential issues that may arise as a result of the process:

- Determine which contracts or transactions to analyze. These could include higher-risk transactions, such as contract R&D, contract manufacturing where development of manufacturing processes and/or quality control procedures are important, distributors when development of marketing intangibles is important, and transactions involving economically significant risks. If numerous entities within a group are performing similar functions and risks, then the analysis can initially be done on a sampling basis or by looking at potentially high-risk countries.
- Determine the parties' functions and risks. In many cases, this will require an "enhanced functional analysis" or "super-functional analysis," such that all economically significant risks are identified and enough facts are ascertained to determine which entities are controlling these risks and how they are controlling these risks.
- Determine what changes, if any, to functions and risks are necessary to conform to the intended characterization of the transaction. With respect to determining changes that can be made to the parties' conduct to support the intended characterization of the entity, the following questions should be considered: Does the parties' actual conduct support the characterization? Can the conduct be changed consistent with the company's business model? Can the management and control of risk be changed consistent with the company's business model?
- Determine the functions and risk described and allocated in the contract.
- Determine "gaps" in the contract (with respect to identifying, allocating, and addressing economically significant functions and risks).
- Make changes to existing contracts or terms of a new contract to eliminate those gaps.

By focusing on these steps, companies may be able to navigate vulnerabilities in their structures that could come to light under the new BEPS regime.

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Bulgaria proposes first-ever mandatory transfer pricing documentation requirements

Bulgaria's Ministry of Finance on 5 November proposed mandatory transfer pricing documentation requirements. The proposed rules are part of the draft changes to the Tax and Social Security Proceedings Code, published on the ministry's website. Public comments on the draft are due on 5 December 2018. If adopted, the law would apply to transactions entered into on or after 1 January 2019.

Current documentation framework

Bulgarian taxpayers currently are subject only to a general obligation to prove the arm's length nature of their transactions with related parties ("controlled transactions") during a tax audit. The rules apply to domestic transactions (those between two Bulgarian companies) and cross-border ones. There is no mandatory term to prepare the transfer pricing documentation before a tax audit.

The content of the documentation is provided in the TP Manual (an administrative rather than legal document) published on the National Revenue Agency's website. The documentation consists of a master file (which provides general information about the taxpayer's group) and a local file with transfer pricing analysis of the taxpayer's controlled transactions.

What's new under the proposal?

Starting from 2019, taxpayers would be obligated to prepare the local transfer pricing file every fiscal year if:

1. Net sales revenue exceeds BGN 16 million, or
2. The net book value of assets as of 31 December of the prior year exceeds BGN 8 million.

Entities not liable to corporate income tax (CIT) or subject to alternative taxes under the CIT Act would be exempt from this requirement.

The local file would be prepared for transactions exceeding certain annual monetary thresholds (BGN 400,000 for goods, BGN 200,000 for services/intangibles/financial assets, and loan transactions in excess of BGN 2 million in loan principal or BGN 100,000 in interest payments). Documentation of controlled transactions with natural persons (except sole traders) is not mandatory.

Entities that are part of a multinational group would also have to provide a transfer pricing master file for the respective year.

The local file would have to be prepared by 31 March of the following year, whereas the master file would be available by 31 March of the year after the following year. For 2019, the local file should be prepared by 31 March 2020, and the master file available locally by 31 March 2021.

The rules explain also how to update the benchmark studies.

The draft does not include a requirement that taxpayers submit the transfer pricing files to the tax authorities. Transfer pricing documentation (both the local file and the master file) would be kept by the local taxpayer and provided to the revenue authorities upon request.

The proposed documentation requirements include sanctions for noncompliance. The level of the fines would depend on the size of the transactions involved, and whether it is a repeat offense, among other factors.

Comments and next steps

The draft law is a logical consequence of the increased interest in transfer pricing matters and a natural follow-up to Bulgaria's declared willingness to implement the elements of the OECD's BEPS project domestically. Parliament is likely to approve this proposal in the coming months, possibly with some small changes after a review of the public comments.

The proposed documentation requirements would impose an additional administrative burden on taxpayers. However, the new rules have a cost-benefit rationale. Transfer pricing compliance covers material businesses and transactions, reflecting higher potential tax risks. This approach makes sense, keeping in mind the size of the Bulgarian economy and its income tax rates.

Taxpayers can expect higher scrutiny during transfer pricing audits. Preparation of the transfer pricing files will help businesses to manage the risk of transfer pricing adjustments and consequently, reduce the risk of penalty interest and sanctions.

In practice, some situations often lead to transfer pricing adjustments and substantial tax assessments. That is the case when businesses are in a loss-making position or when large amounts of service fees (such as management fees or interest charges) are charged within a group. Taxpayers in these situations should prioritize the preparation of their transfer pricing files.

The proposed rules follow international standards, and will provide more clarity to Bulgarian taxpayers on the way they prove the conformity of their intercompany pricing with the market levels. The rules can also provide guidance for taxpayers who are not obligated to prepare transfer pricing documentation and/or have controlled transactions below the statutory thresholds.

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Deloitte's Financial Services Transfer Pricing Conference to be held 28 March 2019

Deloitte is hosting its Financial Services Transfer Pricing Conference on 28 March 2019 in Luxembourg, with an expected 150-200 participants from the financial services industry and FSTP experts from the global Deloitte network.

The conference's theme is "spotlight on technological and regulatory change," and it will feature breakout sessions covering key tax, transfer pricing, and regulatory themes relevant to the banking, asset management, and insurance sectors. In addition, we will explore the following topics:

- Podium discussion on the key regulatory and tax implications of BREXIT, and what to expect;
- Key international tax developments affecting the financial services sector;
- Recent tax controversy trends in the financial services sector and update on the bilateral/multilateral APA landscape;
- The changing role and tax dimension of intangibles in the financial services sector (including the link to IP regimes under BEPS action 5);
- The recent focus by both tax authorities and financial regulators on the topic of tax governance and internal control frameworks (including the tax dimension of the new substance directive in Luxembourg); and

- The ongoing interaction between transfer pricing and indirect tax.

The conference will also feature a client panel focusing on the key challenges for in-house tax/transfer pricing professionals, as well as a panel discussion with representatives of the OECD's Center for Tax Policy and Administration on the future of transfer pricing in the financial services sector.

The conference is by invitation only. Invitations will be sent out in early 2019. To be included in the invitation list, please visit our dedicated website and register your personal details with luevents@deloitte.lu.
URL: https://www2.deloitte.com/lu/en/pages/financial-services/events/financial-services-transfer-pricing-conference.html?id=us:2em:3na:als:awa:tax:121018&sfid=7011O000002Dnpp
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