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OECD releases discussion draft on transfer pricing documentation and country-by-country reporting

The OECD released a discussion draft on 30 January 2014 as part of its work on Base Erosion and Profit Shifting (BEPS), which sets out revised guidance on transfer pricing documentation requirements, in the form of a new draft Chapter V of the OECD's transfer pricing guidelines. As mandated by the G8 and G20, this draft includes a common template for reporting high-level global information to tax authorities on a country-by-country basis, focusing on the global allocation of income, economic activity and taxes paid and taking into account the compliance costs for business. The discussion draft asks a number of questions of business for input on the approach to be taken and the volume of information required. (For additional coverage of the discussion draft, see the 3 February 2014 *Arm's Length Standard* special edition).
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dtt_tax_armslengthstandard_140203.pdf

Interestingly, the introduction to the discussion paper notes it does not reflect consensus views of either the OECD's Committee on Fiscal Affairs (CFA) or Working Party 6 undertaking the work. Given the timing, the OECD decided it was preferable at this stage to seek comments on the common template – covering almost every conceivable piece of information.

OECD proposals – recommendations for a standardized approach

The discussion draft proposes a two-tiered approach to transfer pricing documentation: (i) a "master file" containing standardized information relevant for all group members; and (ii) a "local file" covering, specifically, transactions of the local taxpaying entity. The OECD makes it clear that the proposed master file will be helpful in risk assessment processes but will not be a substitute for a detailed transfer pricing analysis.

Master file – The discussion draft proposes that the master file will contain common standardized information relevant to all entities within a multinational group. Subject to input from business, the country-by-country common template will form part of the master file. The master file also will include a group's organizational structure, a description of business activities and details of intangibles and intercompany financial activities. A section is proposed to include details of advance pricing agreements, other rulings and settlements under mutual agreement procedures.

The proposed common template for country-by-country reporting assumes this will be prepared on an entity-by-entity basis, with information to be provided for each entity or permanent establishment as part of the master file. The template includes details of cash tax paid and withholding tax, revenue, tangible assets, capital and accumulated earnings, number of employees and employee expenses, tangible assets and intragroup royalties, interest and service fees paid and received. The approach envisaged for the country-by-country common template is a "bottom up" one beginning with local statutory accounts, under local GAAP and in local reporting currency, but with an option for businesses to elect instead to use a "top down" approach from consolidated accounting records. Permanent establishments, as expected, will need to be shown separately.

Local file – The local file focuses on information relevant to local transactions, including selection of method, functional and economic analyses and conclusions on arm's length pricing. It also suggests information should be provided on the group's management structure and how the local entity fits into that structure.

Timetable and next steps

The OECD has requested comments from business on the discussion draft by 23 February 2014 – necessary given the extremely tight timetable for the BEPS project overall. The OECD plans to hold two public consultations to discuss the proposals further before they are finalized in September 2014. The OECD also is considering whether information relevant to other aspects of tax and the BEPS Action Plan (outside of transfer pricing) should be included in the common template.

Comments

The state of the discussion draft illustrates that there is, as yet, no agreement on the form of the critical new aspect of transfer pricing documentation – the common template for country-by-country reporting. The proposals look to be both burdensome for companies and badly targeted for tax authorities. Bottom-up reporting almost certainly reflects data not currently gathered by multinationals, and also provides inadequate comparatives for tax authorities since it will not reflect consistent accounting or currency. Some businesses are likely to have concerns about sensitive information being made available on a global basis, even where it does not have a bearing on transactions with a local country. Gathering too much data risks losing sight of the key risk assessment objective. There is, after all, nothing to stop the tax authorities from requesting additional detail should they decide to open an inquiry. It is important that businesses participate actively in the consultation to ensure a workable outcome.

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Belgium:
Decision issued on constitutionality of foreign tax credit rules

Belgium's Constitutional Court issued a decision on the constitutionality of the Belgian foreign tax credit rules on 29 January 2014.

The issue referred to the court by the lower tax tribunal was whether certain provisions of the rules are constitutional that permit companies with a positive taxable base to effectively use the foreign tax credit to avoid international double taxation and decrease their tax burden, while companies with an insufficient taxable base cannot effectively use the entire foreign tax credit, and the treatment of the credit as a disallowed expense reduces their tax losses and eventually creates double taxation.

The court held that the rules that disallow the carryover or refund of an unused foreign tax credit do not violate the constitution, but the rules that require the taxable base to include a foreign tax credit that has not actually been credited are unconstitutional (i.e. only a foreign tax credit that has effectively been credited can be treated as a disallowed expense).

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Honduras:
Tax reform enacted

The Honduras Congress recently approved a law that makes a variety of changes to the Honduran tax rules, effective 1 January 2014. The law, published in the official gazette on 30 December 2013, includes the following measures:

- The introduction of a 1.5% tax on gross income equal to or in excess of HNL 10 million in specific cases, with a lower rate of 0.75% applying to certain taxpayers;
- The introduction of a 10% tax on the gross revenue of air, sea and land companies incorporated overseas and operating in Honduras;
- The introduction of a 10% withholding tax on dividends received by Honduran-resident individuals or legal entities;
- The introduction of a 4% withholding tax on capital gains from the sale of real estate, rights and securities by nonresidents;
- The introduction of a 10% tax on the increase in value of real property;
- The introduction of a 10% tax on payments made for the sale of property, rights and shares;
- The imposition of a 5% solidarity contribution, which must be paid by legal entities (except for entities that fall within the scope of the special import and tourism regimes) on net taxable income above HNL 1 million;
- The repeal of many income tax exemptions;
- The repeal of tax exemptions and duty-free arrangements for importers and nonprofit organizations (with some exceptions); and
- An increase in the goods and services sales tax to 15% (18% in certain cases).

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Korea:
Flat rate individual income tax incentive for foreigners restricted

Revisions to Korea's tax laws for the 2014 tax year include new restrictions on the application of the special flat rate individual income tax available to foreigners, which are intended to limit unreasonably excessive incentives for foreign employees.

Under the Tax Incentives Limitation Law, foreigners working in Korea can elect to be taxed at a 17% flat tax rate (18.7%, including the 10% local surtax), rather than at the normal progressive tax rates (ranging from 6% to 38% (6.6% to 41.8%, including the local surtax)) when calculating their individual income tax liability on earned income. If an election is made for flat rate taxation, the flat rate will be applied to gross earned income, with no deductions, income exclusions or tax credits allowed.

The following changes to the flat rate tax option apply as from 1 January 2014:

- The flat rate tax election will be limited to a maximum of five years from the date the Korean employment commenced. If the foreign individual began working in Korea before 2013, the election will continue to be allowed for a "grace period" until the end of 2014, even if five years have elapsed from the date work commenced.
- A foreigner who has a "special relationship" with the employer will not qualify for flat rate taxation unless the special relationship is with a foreign-invested company entitled to certain special incentives (including a tax reduction and exemption). A special relationship for these purposes means direct/indirect control over management of the company, or status as a family member, spouse, etc. of an individual with direct/indirect control over management.

Companies with foreign employees should check the length of the Korean employment of such individuals to determine whether the five-year limitation for application of the flat tax rate will be exceeded, and if so, they should evaluate the increased Korean income tax liability for affected foreign employees.

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Latvia:
Changes made to credits and incentives regime

On 1 January 2014, the Latvian parliament revised the corporate income tax relief available for large investments and announced a new "super deduction" for certain research and development (R&D) costs.

Corporate income tax relief for large investments

Manufacturing companies investing more than EUR 10 million (increased from approximately EUR 4 million) in Latvia within five years of the date a project is approved can apply for "supported investment project" status. This status provides corporate income tax relief of up to 25% for investments of up to EUR 50 million, and relief of up to 15% for investments exceeding EUR 50 million.

Combined with Latvia's 15% corporate income tax rate, the incentive can lead to very low or no effective tax. The tax relief can be used starting in the tax period in which the investment project is completed, and credits can be carried forward for up to 16 years.

Additional considerations include the following:

- Investments must be made in a supported industry, such as manufacturing, telecommunications, computer programming, warehousing and support activities for transportation;
- Eligible activities include new start-up businesses, new products and significant changes in the overall manufacturing process;
- Eligible costs include manufacturing equipment and accessories; telecommunications or computer programming equipment; and industrial buildings and warehouses, as well as most of the infrastructure of buildings (however, construction costs cannot exceed 40% of the total amount of the investment); and
- The real property where the project will be executed must be owned by the company, or a long-term lease agreement must be registered before the company submits a project application.

Tax relief for investment projects is evaluated by the Ministry of Economy and approved by the government. If the investment amount exceeds EUR 100 million and the tax relief exceeds EUR 28.125 million, the European Commission will be involved in the evaluation process.

Super deduction for R&D costs

A super deduction of 300% of the following applied research and experimental development costs will be introduced as from 1 July 2014:

- Labor costs directly linked to the R&D project;
- Payments to registered scientific institutions for research services directly linked with R&D activities; and
- Payments to accredited certification, test and calibration institutions for testing, certification and calibration services necessary for a new product or technology development.

The government will issue regulations on R&D project documentation and compliance (which are expected to be based, to a large extent, on the OECD's Frascati Manual) by 1 July 2014.This incentive is likely to be granted, provided the taxpayer maintains internal project documentation; the documentation will need to be presented to the tax authorities upon request.

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Netherlands:
New substance requirements applicable for financial service entities

As from 1 January 2014, financial service entities must report on their annual income tax returns whether they satisfy new substance requirements. Financial service entities are Dutch resident taxpayers whose activities during a year consist mainly of paying and receiving interest, royalties, rent or lease installments to or from entities not established in the Netherlands that belong to the same group as the taxpayer. Factors such as types of assets and liabilities, composition of sales, activities performed and how time is spent by the employees must be considered in determining if a taxpayer is a financial service entity. However, activities relating to the holding of participations are excluded from this assessment.

Information that must be reported includes the following:

- The place of business and domicile of the entity;
- Decision-making powers and expertise of the board members;
- The location where management decisions are made;
- The availability of sufficiently qualified staff;
- The location where the company accounts are kept; and
- The country where the bank accounts are held.

In addition, the entity must incur real risks in respect of the legal relationships on which the interest, royalties, rent or lease installments paid and received are based, and the entity's equity must be in sync with those risks.

If a financial service entity does not satisfy one or more of the substance requirements, it must provide the tax authorities with additional data no later than the date the corporate income tax return is filed. The entity must indicate which of the substance requirements has not been satisfied and provide a statement showing foreign jurisdictions in which it has invoked any of the following in respect of interest, royalties, rent and lease installments received: (i) a provision for the avoidance of double taxation in relation to the Netherlands, (ii) the EU interest and royalties directive (IRD); or (iii) a national provision on the implementation of the IRD. The financial service entity also must provide the names and addresses of the entities from which it has received any of the above items of income.

Failure to comply with the disclosure requirements could give rise to an administrative penalty (capped at EUR 19,500 for willful misconduct or gross negligence).

If a financial service entity fails to satisfy the substance requirements and a tax treaty with the Netherlands has been applied abroad or the taxpayer has invoked the IRD or a national provision implementing the IRD, the Netherlands tax authorities will automatically provide the relevant information about the taxpayer to the foreign jurisdiction.

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United Kingdom: Guidance issued on VAT treatment of pension fund investment management costs

On 3 February 2014, the UK tax authorities (HMRC) released guidance analyzing the impact of the Court of Justice of the European Union (CJEU) decision in *Fiscale Eenheid PPG Holdings BC cs te Hoogezand* (*PPG*) on the VAT treatment of pension fund investment management costs, and inviting employers to make claims for under-recovered input tax under certain circumstances.

The *PPG* case involved the VAT treatment of management services paid for by PPG Holdings BV. PPG had set up a separate company pension fund for the purpose of building up pensions for its employees. It paid the pension premiums and incurred all costs on behalf of the pension fund. PPG recovered the input VAT relating to these services in full, on the grounds that the costs were incurred for PPG's own benefit and qualified as its own operating expenses. The Dutch tax authorities, however, took the view that the costs were incurred for the benefit of the company pension fund and, therefore, that PPG was not entitled to recover the input VAT.

The Dutch High Court requested a preliminary ruling from the CJEU on whether a taxable person is allowed to recover input VAT on costs incurred for the benefit of the implementation of the pension provision and the operation of the pension fund. The CJEU ruled that the employer was entitled to deduct input VAT it paid on services relating to the administration of its employees' pension fund and the management of the fund's assets. According to the court, the taxpayer was entitled to recover VAT it paid on pension fund management costs, provided it did not pass such costs on to the pension fund and that there was a direct and immediate link between the services received and the employer's business activities.

To date, HMRC has allowed UK VAT-registered employers to deduct input tax relating to the general management of an occupational pension fund (i.e. the setting up and day-to-day administration of the fund). However, VAT incurred on investment management services has not been treated as VAT that could be recoverable by the employer – it has been treated as VAT recoverable by the pension fund. In circumstances where a single invoice has covered both administration and investment management services, HMRC has permitted employers to recover VAT on a 30/70 split (i.e. to treat 30% of invoiced costs as relating to the employer's activities), in line with previous HMRC guidance.

HMRC's brief

Following the decision in *PPG*, HMRC issued a brief changing its policy on the recovery of input tax incurred on the management of pension funds by removing the 30/70 split, effective immediately (albeit there is a six-month transitional period for situations where the pension fund currently is invoiced for services). In summary:

- HMRC has stated that VAT incurred on pension fund management services now may be treated as input tax of the employer, provided the employer can demonstrate a direct and immediate link between the services received and the supplies it makes.
- HMRC does not consider the VAT to be input tax of the employer where the supplies were not made to the employer or where the supply is limited to investment management services only (i.e. not a combined supply of both investment management and administration services).
- In cases where the employer receives the supply but the pension fund bears the ultimate cost, HMRC has stated that output tax will need to be accounted for by the employer (as it considers this will amount to a recharge to the pension fund).

Next steps

- Affected employers should review the VAT recovery arrangements currently in place for pension fund management services (administration and investment-related services) and consider:
    - Whether claims should be submitted in respect of the past; and
    - Whether the arrangements should be adjusted going forward, and should reassess claims submitted to date in light of the content of HMRC's brief.
- Providers of relevant services should consider whether the VAT treatment applied to their services is in line with HMRC's analysis of the implications of the *PPG* decision, or whether adjustments need to be made to their processes.
- Pension funds should review:
    - The VAT incurred currently treated as their input tax; and
    - The VAT incurred treated as input tax of employers, to determine the potential impact of the changes outlined in the brief.

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Vietnam:
Decree outlines corporate tax incentives

A decree issued by the Vietnamese government on 26 December 2013 (Decree 218) includes a reduction in the corporate income tax rate (from 25% to 22%), as well as guidance on various tax incentives in the Corporate Income Tax Law and the Amended Law ratified by the National Assembly in 2013. Decree 218, which becomes effective on 15 February 2014, will replace the two existing corporate income tax decrees retroactively as from 1 January 2014.

Decree 218 provides the following new rules with respect to the availability of corporate income tax incentives:

- New projects in industrial zones – A two-year corporate income tax exemption, followed by a 50% reduction in the corporate tax rate, will be granted for income generated from new investment projects in industrial zones that are not located in favorable socio-economic areas, as defined. (Previously, incentives were available only for new enterprises or new legal entities, not for new projects).
- Business expansion – A qualifying expansion project will be entitled to incentives applicable for new projects at the same location or in the same industry. However, incentives will not be available where projects result from a merger or acquisition, or for ongoing projects.
- Large-scale investment projects in the manufacturing sector – An enterprise will be entitled to the most beneficial of the available corporate income tax incentives (i.e. a preferential rate of 10% for 15 years; or a four-year tax holiday, followed by a 50% reduction in the tax rate in the following nine years) if either of the following requirements is met:
    - The enterprise has invested at least VND 6,000 billion that has been paid in within three years of the enterprise receiving its investment license, and it has revenue of at least VND 10,000 billion for at least three years after the first revenue-generating year; or
    - The enterprise has invested at least VND 6,000 billion that has been paid in and it has at least 3,000 full-time employees within three years of the receipt of its investment certificate.

  Failure to meet the above requirements will disqualify the enterprise from receiving incentives. Accordingly, the income generated likely would be subject to the standard corporate income tax rate.
- Projects that have not benefited from incentives – An enterprise with an investment project and that has been granted an investment license, certificate or registration, but that did not benefit from a tax incentive by the end of 2013 can benefit from an incentive for the remaining eligible period or, if certain conditions are satisfied, can choose between the existing incentives or the incentives as amended by Decree 218 for the remaining eligible period.

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In brief

Australia – The Australian Taxation Office (ATO) has reorganized its internal structure. The Large Business and International business line now is known as Public Groups and International (PG&I), and the Medium Business line is known as Private Groups and High Wealth Individuals (PGH). PG&I is responsible for all listed entitles, foreign-owned entities and the ATO's international strategy. The ATO also is considering what changes may be needed to its risk differentiation framework approach, rulings, procedures, independent review processes and objections.

Canada – The Canada Revenue Agency (CRA) launched the Offshore Tax Informant Program on 15 January 2014, under which the CRA will pay individuals with information on major international tax noncompliance when they provide information to the CRA that leads to the collection of outstanding taxes due. The initiative, designed to crack down on international tax evasion and avoidance, will allow the CRA to pay an individual informant if the information results in total additional assessments or reassessments exceeding CAD 100,000 in federal tax. The payment can be between 5% and 15% of the federal tax collected and will be granted once all recourse rights related to the assessment have been exhausted.

Colombia – As from 20 November 2013, for tourist and hotel services provided in Colombia to foreign individuals to be VAT-exempt, the services must be provided as part of a tourist package or a package supplied by a travel agency, or a hotel must be listed in the National Tourism Register. If the exemption is not available, the VAT rate is 16%.

European Union – The European Commission has decided to take Portugal to the Court of Justice of the European Union for discriminating against taxpayers that cease to be tax resident in Portugal. Under Portuguese tax law, taxpayers no longer resident in Portugal are subject to immediate taxation in the case of an exchange of shares. Taxpayers also are taxed immediately in cases of a transfer of assets and liabilities related to the exercise of an economic or professional activity to a company located abroad. The Commission sent reasoned opinions to the Portuguese authorities on 3 November 2009 and 22 November 2012 formally requesting them to amend this legislation. The response given by Portugal was not considered satisfactory.

European Union – The European Commission has announced that its cross-border VAT rulings trial, which aims to facilitate cross-border VAT rulings for taxpayers on contentious or inconsistent issues, is being extended for another year. The 13 EU member states that participated from the outset (Belgium, Cyprus, Estonia, France, Hungary, Latvia, Lithuania, Malta, Netherlands, Portugal, Slovenia, Spain and the UK) are to be joined by Finland (and the trial is open to the remaining EU member states to join as well). A "mid-term" review is to be carried out in June 2014, and if the experiment proves to have been successful, a cross-border VAT ruling process may be developed.

Lithuania – The maximum amount of accumulated and carried forward tax losses resulting from general business activities that may be offset against taxable income from general business activities in a given year cannot exceed 70% of the taxpayer's taxable income in that year. This limit does not apply to companies whose income is taxed at a 5% corporate income tax rate. This provision applies when calculating corporate income tax for 2014 and subsequent tax periods.

Luxembourg – The prime minister has announced that, in September or October 2014, the standard VAT rate will increase from 15% to 17%. Even with the increase, Luxembourg's VAT rate still will be among the lowest in the EU. The increase in the rate will have a significant organizational impact, and VAT payers should be prepared to amend their VAT data systems to be able to carry out the billing process with two different standard VAT rates applicable within the same calendar year.

Thailand – A decree approved on 23 December 2013 sets out the new personal income tax rates that apply for 2013 and 2014 personal income tax returns. The highest rate now is 35%. The new rates have seen the introduction of the 5%, 15%, 25% and 35% tax brackets, and the expansion of four tiers of tax brackets to seven tiers of tax brackets. The introduction of the 15% and 25% rates is intended to offer greater tax relief to middle income taxpayers, but high income taxpayers also will benefit from the revised rates. Given that the revised rates were enacted into law late in 2013, many taxpayers likely will be entitled to refunds.

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Australia

New draft legislation released on investment manager regime

On 30 January 2014, the Australian government released a third version of exposure draft legislation for the third and final element of the investment manager regime (IMR), which also amends already-enacted elements of the IMR. Two previous versions of this draft legislation were released in April and July 2013.
[Issue date: 5 February 2014]
URL: http://www2.deloitte.com/global/en/pages/tax/articles/global-tax-alerts.html?id=us:em:na:wta:eng:tax:021414
URL: http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-alert-australia-050214.pdf?id=us:em:na:wta:eng:tax:021414

OECD

The OECD’s Discussion Draft on Transfer Pricing Documentation and Country-by-Country Reporting: A work in progress

The Organization for Economic Cooperation and Development on January 30 released a discussion draft on transfer pricing documentation and country-by-country reporting as part of its work on base erosion and profit shifting. The discussion draft sets out revised guidance on transfer pricing documentation requirements in the form of a new draft Chapter V of the OECD’s transfer pricing guidelines, and includes a common template for the reporting of detailed global information to tax authorities on a country-by-country basis, focusing on the global allocation of income, economic activity, and taxes paid.
[Issue date: 3 February 2014]
URL: http://www2.deloitte.com/global/en/pages/tax/articles/arms-length-standard.html?id=us:em:na:wta:eng:tax:021414
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