

Transfer Pricing

Review of OECD's Draft Handbook on Transfer Pricing Risk Assessment from Croatian perspective



Indicators for transfer pricing risk assessment

The Organization for Economic Cooperation and Development (OECD) on April 30 2013 released the Draft Handbook on Transfer Pricing Risk Assessment for public consultation.

The objective of the draft handbook is to provide a practical resource tax administrations can use to assess transfer pricing risk for an individual taxpayer in their respective jurisdictions.

Being able to select appropriate audit targets is critical to minimize wasted resources, both for tax administrations and for taxpayers subject to audits, which frequently span multiple years and involve hundreds of hours of cumulative effort.

OECD's Draft Handbook on Transfer Pricing Risk Assessment

The draft handbook is meant to aid tax administrators by proposing activities that should be performed before the decision is made to undertake a serious commitment of resources investigating taxpayer's primary sources.

Taxpayers can also use this guidance to evaluate their own transfer pricing risk profile. The most relevant information in the draft handbook for taxpayers is its identification of risk factors, which should be used to evaluate risk facts which taxpayers should be selected for a formal transfer pricing audit.

Some of the key risk factors identified in the draft handbook are included in the table below.

Summary of Risk Factors Highlighted in the Draft Handbook

Broad Risk Factor Category	Risk Factor Examples
Payments which decrease the tax base (Base eroding payments)	Royalties, rental payments, management fees and charges for other related-party services, financial instruments including other transactions, including large-volume sales or purchases of products or services.
Tax attributes of related nonresident parties	Examples include material transactions with related entities in low-tax jurisdictions or they have preferential tax treatment.
Large one-time transactions	The transactions that have the potential to impact the transfer pricing relationships between group members in future years, such as business restructuring.
Profitability anomalies	In comparison to industry standards and comparable companies or in comparison to related parties, as well as persistent operating losses over a period of years or fluctuations that are contrary to market trends.

The draft handbook also identifies that one of the risk factors is not submitting of Transfer pricing study to the tax authority.

The draft handbook identifies indicators of low transfer pricing risk, such as low volume of controlled transactions, the presence of comparable uncontrolled transactions that are used to establish the transfer price, transactions with entities in jurisdictions with relatively higher marginal tax rates, and the presence of minority shareholders whose interests would be influenced by the division of profit between the related parties.

Providing sufficient transfer pricing documentation on a contemporaneous basis when requested and cooperating with tax administrations such are controllable factors that may influence a tax administration's risk assessment of a taxpayer.

The draft handbook makes recommendations in respect of what information tax administrations should require in information return forms, including:

1. Identification of related-party transactions;
2. Identification of related parties with which controlled transactions are carried out;
3. Nature and amount of controlled transactions carried out with each related party;
4. Segmented financial results of each controlled transaction; and
5. Description of the differences between a taxpayer's financial statement and its income tax return income (i.e. book/tax differences).

Potential impact to the Croatian taxpayers

The Croatian tax authority has already shown interest in moving toward a risk-based audit selection approach. It means that the Croatian tax authority is already applying guidance prescribed by the draft Handbook published by OECD.

The Croatian tax authority generally does not publicize its risk assessment process. The draft handbook is a useful resource in that it provides significant detail regarding what the Croatian tax authority may consider when performing a risk assessment and filtering transfer pricing audit candidates.

The draft handbook therefore provides Croatian taxpayers a useful glimpse at what may be considered by tax administrators when evaluating transfer pricing risk and selecting audit candidates. By understanding the risks identified in the draft handbook, taxpayers can prepare themselves by thoroughly documenting transfer pricing transactions – particularly those identified in the draft handbook's risk factors.



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