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Global Transfer Pricing

Arm's Length Standard

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OECD Issues Country-by-Country Reporting Implementation Package

The OECD on 8 June released *Action 13: Country-by-Country Reporting Implementation Package* as part of the G20/OECD work on the Action Plan to address Base Erosion and Profit Shifting (BEPS), This follows two reports previously issued by the OECD: (i) the agreement of a three-tier global standard for transfer pricing documentation, including a common template for county-by-country information to be reported to tax authorities (released September 2014); and (ii) implementation guidance in relation to the country-by-country report, including the timing of introduction, application to "large" businesses, and filing mechanisms (released in February 2015). The implementation package outlines model legislation that governments can use to adopt the new rules, as well as competent authority agreements to implement the sharing mechanisms for the country-by-country report.

Model legislation

The implementation package includes model legislation for countries to adopt country-by-country reporting in their domestic legislation.

Definitions

The model legislation includes, among others, some key definitions:

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- **Group:** A collection of enterprises related through ownership or control that is either required to prepare consolidated financial reporting statements, or would be so required if “equity interests in any of the enterprises” were publically traded on a stock exchange.
- **Excluded multinational enterprise group:** A group with consolidated group revenue of less than EUR 750 million on 1 January 2015 at local currency rates. This will be tested against the results of the previous fiscal year. Such a group will be exempt from filing the country-by-country report.
- **Constituent entity:** Any separate business unit of the group, including companies together with permanent establishments that prepare a separate financial statement for any purpose (including management control).

The model legislation sets out how to determine which constituent entity is required to file the country-by-country report (i.e., the “reporting entity”). This usually will be the “ultimate parent entity,” as the company that prepares consolidated financial statements for the group. When the ultimate parent entity (a) is not required to file a country-by-country report in its jurisdiction; (b) that jurisdiction has not signed on to the relevant information exchange agreements, or; (c) the jurisdiction has systematically failed or suspended its agreement to exchange information, the group can appoint a “surrogate parent entity.” This is a constituent entity within the group, in an appropriate jurisdiction with the ability to exchange information that is nominated to file the country-by-country report in its jurisdiction on behalf of the group.

If, under certain circumstances, the country-by-country report is not filed with and shared by the tax jurisdiction of either the actual parent company or a surrogate, then companies may be required to file the country-by-country report locally. The model legislation allows a nominated constituent entity within a jurisdiction to file the report on behalf of all constituent entities in that jurisdiction.

Notification

Each constituent entity will need to notify their local tax authority by the last day of the financial reporting year either (i) that it will be filing the country-by-country report for the group for the year, or (ii) the name and tax residence of the company that will file the report for that fiscal year.

Timing for preparation and filing of country-by-country reports

As previously announced, the G20/OECD proposes that country-by-country information should be required for years beginning on or after 1 January 2016 and be filed annually within 12 months of the end of the financial reporting year to which it relates. Groups with a year ending 31 December 2016 will be first to file, with a deadline of 31 December 2017. The contents of the country-by-country report will be as set out in the template issued in the OECD’s September 2014 report. The model legislation does not include specific penalty provisions for noncompliance. Rather, it leaves this for individual jurisdictions to determine in line with existing transfer pricing documentation penalties.

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Competent authority agreements

The implementation package includes three model competent authority agreements that could be used by tax authorities to facilitate implementation of the exchange of country-by-country reports:

- Multilateral competent authority agreement: a multilateral agreement that allows jurisdictions to sign up and exchange information with all other appropriate jurisdictions signed up to the same agreement (based on the model used for the Common Reporting Standard);
- Tax treaty competent authority agreement: to be agreed on a bilateral basis;
- Tax information exchange agreement competent authority agreement: to be agreed on a bilateral basis.

The three model agreements are worded similarly, including definitions that are consistent with the model legislation and include the scope, timing, procedures, and safeguards that apply to the automatic exchange.

Timing of exchange of information

Tax authorities will be required to share the country-by-country information with other relevant tax authorities within 18 months of the end of the financial reporting year for the first year, then within 15 months of the end of the financial reporting year for subsequent periods. For example, a group with a year ending December 31, 2016, will file its first country-by-country report by December 31, 2017, which then would be shared with other relevant tax authorities by June 30, 2018 (and then, for the year ending December 31, 2017, by March 31, 2019).

Confidentiality and safeguarding information

The exchange agreements make clear that information shared as a result of these agreements must be kept confidential and used appropriately. In particular, the agreements reiterate previous requirements that the information should not be used as a substitute for detailed transfer pricing analysis of individual transactions based on full functional and comparability analysis, and that transfer pricing adjustments should not be made on the basis of the country-by-country reporting alone. In addition, there are proposals to deal with tax authorities that breach confidentiality, or otherwise fail to comply with the terms, by excluding them from future information exchanges.
The implementation package also includes a questionnaire that outlines requirements for data safety and security for tax authorities to adhere to under normal international standards.

Comments and business next steps

The implementation package is designed for governments to introduce the country-by-country report into their respective domestic legislation. In addition, it provides details of the exchange of information mechanisms by which tax authorities will share the country-by-country report with their counterparts in countries where the taxpayer has a company or permanent establishment. The provision of model legislation (a first for the OECD in the area of international corporate taxation) is in clear support of the G20/OECD objective that the

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country-by-country report is to be a single international standard. As such, it is to be implemented consistently by all participating countries. Business will welcome such uniformity, which will be helpful in mitigating unnecessary compliance costs.

While the implementation package is clear that it is intended primarily for governments, there are a number of definitions that will be relevant to businesses. In particular, the model legislation sets out the meaning of the term “group” for purposes of preparing the country-by-country report, basing the definition on groups required to prepare consolidated financial statements, or those that would have to if any of its “enterprises” were publically traded. There are no separate definitions in relation to the accounting rules for funds (which were specifically mentioned in the February 2015 implementation guidance as requiring further consideration).

Businesses that have a parent company in a country that does not adopt the country-by-country report, or does not share the report under the mechanisms proposed, will be helped by the option to elect a “surrogate parent.” Under this option, the group will have confidentiality protections for its information and will be required to prepare and file the country-by-country report only once, rather than locally in each country where it has operations.

The model legislation proposes an annual notification requirement such that all resident companies (including, presumably, dormant companies that are subject to the listing in the activities section on the second page of the report template) must notify the tax authorities in their country of the identity and residence of their reporting entity – the group parent company or its elected surrogate.

The model legislation does not suggest a specific penalty regime in respect of the country-by-country report, but instead refers to extensions of existing country transfer pricing documentation penalty regimes to the requirements on the reporting entity to file the country-by-country report. This is appropriate in that the inference is that penalties for noncompliance should be restricted to the reporting entity rather than imposed on group companies with little or no control over the information provided.

As expected, the sharing of information will be by a suitable mechanism, either under existing tax treaties, tax information exchange agreements, or under the OECD’s Convention on Mutual Administrative Assistance in Tax Matters (which has been signed by more than 80 countries to date). Businesses will be pleased to see specific safeguards around confidentiality of data, and, as expected, restrictions on the use of the information to transfer pricing/BEPS risk assessment and economic analysis only.

The country-by-country report will have to be filed electronically in a tagged format. The OECD will release the xml tagging schema shortly and is currently looking at tax authority systems to enable the exchange of data in a secure, electronic manner. The first exchanges are planned to take place six months after the filing due date for the first year (i.e., June 2018) and in subsequent years, three months after the filing due date.

There is no further guidance on the master file and local file approach to transfer pricing documentation proposed alongside the country-by-country report. Some businesses were disappointed in February that the master file would not be subject to a parent-filing and government-sharing mechanism as for the country-by-country report; therefore, issues may

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remain in relation to enabling local filing of group information that is not in the possession of the local entity.

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OECD Releases Draft Guidance on Cost Contribution Arrangements

The Organization for Economic Cooperation and Development (OECD) on April 29 released a nonconsensus discussion draft on cost contribution arrangements (CCAs) that contains proposed revisions to Chapter VIII of the OECD's transfer pricing guidelines. The CCA discussion draft was issued in relation to the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan under Action 8 (transfer pricing valuation with respect to transfers of intangibles). Comments from the public are invited and due by May 29, 2015. A public consultation on this draft and other transfer pricing topics is scheduled for July 6-7 at the OECD's Paris headquarters.

The CCA discussion draft primarily updates the existing guidance to take into account guidance released under other BEPS action items, rather than take a fresh look at CCAs. The CCA discussion draft incorporates draft guidance on: (1) risk in Chapter I of the OECD transfer pricing guidelines released in December 2014 (the "Risk Draft"); and (2) taxation of transfers of intangibles in accordance with the value attributable to such intangibles in Chapter VI of the transfer pricing guidelines released in September 2014 (the "Intangibles Draft"). Thus, to the extent that the Risk Draft and the Intangibles Draft, including any changes on hard-to-value intangibles and special measures, undergo further revisions to reach consensus among OECD member countries, the CCA draft is likely to also undergo revisions to be consistent with the other discussion drafts.

Consistent with the current guidance, the CCA discussion draft applies to both service CCAs, in which participants share the cost of services, and development CCAs, in which participants share the costs and risk of developing property. The CCA discussion draft takes the position that the outcome of operating within the context of a CCA should be the same as if the CCA had not existed. Therefore, both initial contributions to the CCA and ongoing contributions must be measured by value rather than cost. The CCA discussion draft provides one exception to this rule for low-value services, for which valuation of contributions at cost is permitted.

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Example 2 in the Annex to the discussion draft illustrates this principle. The value of each participant's contribution is determined by reference to the other chapters of the OECD's transfer pricing guidelines, in particular Chapter VI for intangible development CCAs. The requirement that contributions be based on value rather than costs is more limiting than the current guidance, but aligns with the BEPS Action Plan and the increased emphasis on value splits. Nonetheless, the requirement to use value rather than cost is the change likely to have the greatest impact on existing CCAs.

The CCA discussion draft requires that a participant must benefit from the CCA activity. For development CCAs, every participant must be able to participate in controlling and managing the risk that is contractually assigned to it under the CCA. Thus, a "cash box" entity that only provides funding would not be allowed to be a participant in a development CCA, as discussed in Example 5. However, consistent with the Intangibles Draft, a participant that participates in control and management but only provides funding may have its returns limited to a risk-adjusted return on its funding activities. See Example 4.

Each participant's initial and ongoing contributions to the CCAs activities should be based on their reasonably anticipated benefits from the CCA activity (RAB). If the value of a participant's overall contributions is not equal to its overall expected RAB, a balancing payment is required to "top up" the value of the participant's contribution. For this purpose, both initial contributions and ongoing contributions are analyzed together to determine whether each participant's contribution is equal to its RAB. The guidance permits taxpayers to include in their CCAs an adjustment clause that enables taxpayers to make future adjustments to their contributions to adjust contributions to changes in RAB. The potential scope of an adjustment clause is unclear. For example, could the adjustment clause permit a downward adjustment to a participant's contributions if an intangible did not perform as well as projected both in the aggregate and relative to the other participants?

The guidance permits tax authorities to make an adjustment to a participant's contribution to "top up" a payment if contributions: (1) are not consistent with the actual RAB shares of each entity; or (2) are not consistent with the actual value attributable to the contribution. The CCA discussion draft is unclear on whether this analysis is to be based solely on *ex ante* information or whether adjustments may be made based on *ex post* information.[1] The CCA draft indicates that, in the case of development CCAs, it may be appropriate for tax authorities to consider multiple years rather than a single year's results in determining whether an additional balancing payment should be made to align contributions with projected RAB. The guidance appears to require exact alignment of contributions and RAB over time and does not provide a range of permitted deviations between contributions and RAB, which will undoubtedly occur over the course of a development CCA.

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[1] Compare Par. 17 of the discussion draft, which states that the analysis should not utilize hindsight, with Par. 19, which requires adjustments based on actual benefits. It is unclear whether Par. 19 requires a US-style "commensurate with income" (CWI) type of adjustment, but without any of the exceptions to such CWI adjustments that are found in the US cost sharing regulations (in Treas. Reg. 1.482-7(i)(6)). If the OECD is going to implement such CWI-like adjustments, the concomitant safe harbors and exceptions to such adjustments to avoid adjustments for minor deviations that would be inconsistent with the arm's length standard should also be considered.

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The CCA discussion draft contains recommendations for structuring and documenting a CCA that make only minor changes to the existing guidance. The guidance on documentation contains a detailed list of items that taxpayers should be prepared to provide tax authorities. However, the list is not coordinated with the new documentation requirements contained in Chapter V, which leaves open the question of what information regarding CCAs must be included in either the master or local files.

Multinational entities (MNEs) that have an entity that is a participant in a cost sharing arrangement (CSA) governed by the US cost sharing regulations should be aware that the CCA draft takes a very different approach to the taxation of CCAs than the US regulations in several ways:

- The "cash box" entity described in Example 5 would be allowed under the US cost sharing regulations, because the US rules do not have a control and management requirement;
- Under the US cost sharing regulations, CSA participants share the intangible development costs related to the intangible development activity of the CSA "at cost" rather than "at value" as called for under the CCA draft;
- Initial contributions and ongoing payments are tested separately rather than combining the two; and
- Any commensurate with income-type adjustments are subject to safe harbors and other exceptions.

MNEs with CCAs governed by other local regulations should review the existing terms and conditions to identify potential differences with the CCA discussion draft, in particular regarding sharing "value" instead of "costs."

MNEs that have existing CSAs/CCAs in place – in particular CSAs that comply with the US cost sharing rules – should be alert and watch for the final CCA rules to determine to what extent the final CCA guidance is inconsistent with existing local regulations, and to what extent additional actions may be required to address those inconsistencies.

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OECD Issues Discussion Draft on Hard-to-Value Intangibles

The Organization for Economic Cooperation and Development (OECD) on June 4 released a non-consensus discussion draft on Action 8 of its base erosion and profits shifting (BEPS) plan regarding hard-to-value intangibles. Interested parties are invited to submit comments to the

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OECD by June 18, and a public consultation on this and other transfer pricing topics will be held July 6-7 at the OECD Conference Center in Paris.

The discussion draft updates the current language in Chapter VI of the 2010 version of the OECD's transfer pricing guidelines relating to aspects of hard-to-value intangibles (this language was bracketed and shaded in the 2014 BEPS report, Guidance on Transfer Pricing Aspects of Intangibles). The proposed new guidance focuses on Option 1 of Part II of the discussion draft on revisions to Chapter I of the transfer pricing guidelines issued December 19, 2014, dealing with transfer pricing rules or special measures for hard-to-value intangibles (HTVI). Option 1 introduced the ability for tax administrations to use, under certain circumstances, ex-post results of an intangible transfer as presumptive evidence that taxpayers would have adopted contingent payment mechanisms.

Arm's length pricing when valuation is highly uncertain at time of transaction

The discussion draft states that, when valuation of an intangible or rights in an intangible at the time of the transaction is highly uncertain, and questions arise as to how arm's length pricing should be determined, the questions should be answered by reference to what independent enterprises would have done "to take account of the valuation uncertainty."

According to the discussion draft, there are a number of pricing arrangements that independent parties may agree upon, depending on the facts and circumstances. In cases when subsequent developments are sufficiently predictable to make forecasts reliable, independent parties may use projections of anticipated benefits to fix a price (*ex ante* pricing) at the outset of the transaction, regardless of the eventual outcome of the benefits. In other cases, independent parties might conclude that pricing based on anticipated benefits alone does not provide adequate protection against the risks posed by the high uncertainty in valuing the intangible. In those cases, independent parties might:

- Adopt shorter-term agreements;
- Include price adjustment clauses in the agreement;
- Adopt payment structures involving periodic milestone payments;
- Adopt a royalty rate set to increase as the licensee's sales increase; or
- Agree to renegotiate the pricing arrangement if major unforeseen developments occur, changing the fundamental assumptions on which the pricing was determined.

The discussion draft states that if independent parties would have adopted price adjustment clauses, tax administrators should be permitted to determine pricing based on such clauses.

The discussion draft identifies the difficulties tax authorities face in verifying the developments or events the parties could or should have taken into account when the pricing was determined. It suggests that information asymmetry between tax authorities and businesses regarding the business and its environment may give rise to a risk of systematic mispricing.

Hard-to-value intangibles

The discussion draft sets out features for HTVI that may be subject to special considerations. HTVIs are intangibles for which, at the time of their transfer between group companies, (i) no

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sufficiently reliable comparables exist; and (ii) there is a lack of reliable projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain.

Intangibles that fall within the category of HTVIs may exhibit one or more of the following features:

- Intangibles that are only partially developed at the time of the transfer;
- Intangibles that are not anticipated to be exploited commercially until several years following the transaction;
- Intangibles that separately are not HTVI but that are connected with the development or enhancement of other intangibles that fall within the category of HTVI; and
- Intangibles that are anticipated to be exploited in a manner that is novel at the time of the transfer.

The situations that may exhibit attributes of HTVIs may encompass a broad range of intangibles, making the guidance in the discussion draft potentially applicable to many intangible transfers.

The discussion draft proposes that, when there is a transfer of HTVIs and there is a significant difference between ex post outcomes and ex ante projections, tax authorities may impute contingent arrangements that use actual results in years subsequent to the transfer. However, when the tax authorities are able to confirm the reliability of the forecast information on which the pricing has been based, price adjustments based on actual outcomes should not be made. The discussion draft includes a specific exception whereby a review of actual outcomes should not affect pricing used by the business if the business provides (i) full details about the forecasts used in the pricing calculation; and (ii) satisfactory evidence that any significant difference between the financial forecasts and actual outcomes was due to unforeseeable developments. Examples of unforeseeable developments include the unexpected bankruptcy of a competitor or a natural disaster occurring after the transaction.

Comments

Although the discussion draft does not use the term “commensurate with income,” the conceptual framework discussed in the guidance appears to be similar to the US commensurate with income concept and periodic adjustments rules.

Because the motivation for the guidance provided in the discussion draft relies on the asserted information asymmetry between taxpayers and tax administrations, taxpayers are not likely to be able to rely on the guidance to make self-initiated ex-post-based adjustments to their results. This issue has been, and still is, controversial under US rules.

There are several areas in which additional clarification would be helpful, including the following:

- The discussion draft states that the benefit of hindsight should be used only to adjust ex-ante pricing in situations when significant differences between financial projections and actual results exist. The inclusion of US-style safe harbors requiring the deviation

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between ex ante and ex post results to be greater than 120 percent or less than 80 percent of the expected ex ante value may be helpful in reducing uncertainty.

- The inclusion of additional examples allowing assessment of ex post outcomes, such as unanticipated macroeconomic events (recessions, depressions, or greater than expected economic growth) and unforeseen governmental actions may be helpful.
- Limits in time from the date of the original transaction for the application of the special considerations appear reasonable. For example, it would not be appropriate to look back 15 years to test a transaction, except in situations involving extremely long development periods.
- Additional clarification as to what the words “partially developed,” “several years following the transaction,” and “novel” mean with respect to the situations that may reflect HTVI considerations to limit the potential situations in which special considerations would be helpful.
- The discussion draft is silent on whether contingent price clauses included in agreements will be respected, thereby permitting taxpayers to make positive and negative adjustments to their initial valuations without the aid of the mutual agreement process. Clearly permitting such clauses would help reduce uncertainty.
- Whether the proposed changes are considered special measures outside of the arm’s length standard or consistent with the arm’s length standard. The initial sections of the discussion draft appear to make the case that the changes are within the arm’s length standard, similar to the US commensurate with income rule. However, commentators may disagree. If the special considerations do not reflect the arm’s length principle, amendments to double tax treaties would be required for them to be effective (both to article 9 of the OECD model treaty and to bilateral tax treaties, which could be achieved through the proposed multilateral instrument under the BEPS project).

On an OECD webcast on June 8, Marlies de Ruiter, head of the OECD’s Tax Treaty, Transfer Pricing, and Financial Transactions division, announced the OECD would not release an updated version of the discussion draft on revisions to Chapter I. Additional information on the revisions to Chapter I and guidance on other BEPS actions will be provided at the OECD consultation in Paris July 6-7.

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Thai Cabinet Approves Transfer Pricing Documentation Rules

The Thai Government Cabinet has approved draft revisions to the tax laws that require taxpayers to prepare transfer pricing documentation, with significant fines for failure to do so.

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Thailand has had transfer pricing guidelines since 2002. Those guidelines were essentially in line with OECD transfer pricing methods and documentation requirements. However, those guidelines were issued only as guidance to Revenue Department officers when performing tax audits, and did not carry the force of law.

On May 7, the Cabinet approved in principle a draft act of additional amendments to the Revenue Code [Preventive Measure of Transfer Pricing between Related Juristic Corporations or Partnerships] proposed by the Ministry of Finance. The draft act will be submitted to the Council of State Committee and then the National Coordination Legislative for consideration before being presented to the National Legislative Assembly.

The draft act will add provisions to the Revenue Code to provide criteria for analyzing transfer pricing between related corporations or partnerships, and to empower assessment officers to adjust income and expenses accordingly. The additional provisions also will specify the prescription period for tax refund requests and require related corporations or partnerships to submit transfer pricing documentation to the assessment officer.

The proposed amendments are as follows:

1. In circumstances where two or more related corporations or partnerships with direct or indirect relationships in capital, management, or control have agreed commercial and financial conditions that are different from those agreed between independent parties [for the same or similar transactions], the assessment officer is empowered to adjust income or expenses for those transactions.
2. In circumstances where a transfer pricing assessment results in overpayment of income tax or over-deduction and over-remittance of withholding tax by related corporations or partnerships, they have the right to submit a tax refund request within 60 days from receipt of the assessment, or within three years from the due date of the filing of the tax return to avoid double taxation.
3. Within 150 days from the last day of each accounting period, the related corporations or partnerships mentioned in paragraph 1 are required to submit documents or evidence to present their direct or indirect relationships in capital, management, or control and method(s) to determine intercompany income and expenses [*transfer pricing documentation*] to the assessment officer. Failure to submit the documents or evidence within the prescribed period or prepare the documents or evidence truthfully will result in a maximum fine of THB 400,000.

The proposed changes to the law are quite general; detailed guidance will be released by the Thai Revenue Department as supporting regulations after approval of the new law. Drafts of the supporting regulations are not publicly available, but based on comments by senior Revenue Department officers, we understand that:

- The transfer pricing methods will be consistent with the OECD transfer pricing methods.
- The information required in the transfer pricing documentation will be similar to that required under the current guidelines, which itself is similar to the traditional OECD-based transfer pricing documentation.
- It does not appear, at least initially, that the Thai Revenue Department will adopt the proposed OECD BEPS documentation requirements (master file, local file, and country-

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by-country report). Given that other South East Asian countries appear to be willing to adopt the new documentation requirements, we expect that the Thai Revenue Department will also ultimately follow suit.

- There may initially be no de minimis thresholds or safe harbors for the preparation of transfer pricing documentation. Given the significant fine for failure to prepare documentation, we hope that this will be addressed in the short term to alleviate the burden on companies with low levels of related-party transactions.
- The draft law seems to indicate that transfer pricing documentation must be lodged within 150 days after the end of the accounting period. However, it is not clear whether physical lodgement will be required or only a certification provided that the transfer pricing documentation has been prepared.
- The corporate tax penalty regime will apply to any transfer pricing adjustments made as part of a tax audit. There will not be any specific penalty protection associated with the preparation of transfer pricing documentation. However, there is a standard penalty reduction of 50 percent if taxpayers cooperate in the audit process. We expect the Thai Revenue Department to recognize taxpayers who prepare transfer pricing documentation as qualifying for the penalty reduction.
- The regulations will also address advance pricing agreements.

It is not clear when the revisions to the law will be passed by parliament, and which will be the first effective year of application of the new documentation rules. However, because it is possible that the rules will cover the 2015 year, we suggest companies carefully consider the potential application of these rules as soon as possible.

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Poland Introduces Significant Changes to Documentation Requirements

Poland plans to introduce significant changes to its transfer pricing documentation requirements. According to the Draft Amendments to the Corporate Tax Acts published on the website of the Polish Government Legislation Center on April 28, the new legislation is expected to enter into force as of January 1, 2016.

Entities subject to transfer pricing documentation requirements

The draft legislation introduces a three-tiered approach to transfer pricing documentation: local documentation (the local file), documentation for a group of companies (the master file) and a report on the global allocation of income and tax within the group (the country-by-country report).

According to the draft legislation, the obligation to prepare transfer pricing documentation will apply to taxpayers whose revenues or costs exceed the equivalent of EUR 2 million for the tax year. The draft provides that the new transfer pricing documentation requirements also will apply to taxpayers that conduct their business operations through partnerships, giving them

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the opportunity to appoint a partner responsible for drafting the documentation. However, this appointment does not release the remaining partners from their responsibilities in this regard.

Taxpayers whose revenues or costs exceed the equivalent of EUR 10 million in a given tax year also will be obligated to prepare benchmarking studies.

If the taxpayer's revenues or costs exceed the equivalent of EUR 20 million in a given tax year, the taxpayer will be also obliged to prepare documentation that will contain information about the whole group of related parties (the master file).

The largest entities – those whose revenues exceed the equivalent of EUR 750 million in a given tax year – will be subject to an additional obligation to produce a report on the income and tax paid by subsidiaries, their places of conducting business, as well as their permanent establishments (country-by-country report).

Scope of transfer pricing documentation

In line with the draft amendments, taxpayers will be obligated to prepare tax documentation not only in respect of their transactions with related parties but also in respect of other events recognized in the books of accounts, the terms of which have been determined (or imposed) with their related parties, including the contracts for finance management (e.g., cash pooling), cost sharing agreements, agreements related to the incorporation of entities that are not legal persons, joint venture contracts, and other comparable agreements.

Content of transfer pricing documentation

The documentation prepared by taxpayers whose revenues or costs exceed the equivalent of EUR 2 million but do not exceed the equivalent of EUR 10 million in a given tax year should contain descriptions of:

- The taxpayer's organizational and management structure;
- The business activity conducted;
- The economic strategy, including transfers of economically material functions or assets or risks that have an impact on incomes (loss), reported in the tax year or during previous tax years; and
- Business environment.

In addition, the documentation prepared with respect to these taxpayers should contain descriptions of transactions and other events, including:

- An indication of the type of the transactions that materially impact the amount of the income (loss);
- A description regarding compliance with the terms of the transactions with related parties, and the terms that would otherwise have been agreed upon by unrelated parties;
- Financial data, including cash flows related to the transactions or other events;
- Documents that materially impact the transactions or other events;
- A description of the analysis of assets, functions, and risks;

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- A description of the method and manner of calculating the income and justification for their choice;
- The algorithm for settling the transactions or other events, together with the method of calculating the values affecting the income (loss) of the taxpayer or the taxpayer's partner; and
- The taxpayer's financial data supported with the financial statements, after they are approved.

In the case of taxpayers whose revenues or costs exceed the equivalent of EUR 10 million, but do not exceed EUR 20 million in a given tax year, documentation should additionally contain a benchmarking study based on benchmarking data used in calculating the intercompany settlements, and in particular local comparables relevant for entities with a registered office or management in the territory of Poland, as well as indicating the source of the data.

Taxpayers whose revenues or costs exceed the equivalent of EUR 20 million in the tax year will also be obligated to draw up tax documentation concerning a group of entities (the master file) which should contain, inter alia:

- The name of the related party that prepared the documentation;
- The organizational structure of the group of related parties;
- A description of the rules for determining transactional prices (group transfer pricing policy) followed by the group;
- A description of the business activity conducted by the group;
- A description of the intangible assets possessed, created, developed, and used by the group;
- A description of the financial situation of the group entities, specifically including the consolidated financial statements of related parties comprising the group; and
- A description of agreements with the tax authorities of other countries regarding income tax, especially advance pricing agreements.

Other changes

The draft amendments impose the following obligations and requirements:

- A duty to prepare tax documentation no later than the date of submission of the tax return for the respective tax year;
- A requirement to have a statement confirming preparation of complete documentation within the statutory deadline signed by a member of the management board of the local entity or a person representing a foreign entity. The statement should be attached to the tax return filed for the given year;
- A requirement to have the transfer pricing documentation verified periodically, at least once a year (however, benchmarking analyses should generally be subject to verification once every three years); and
- An obligation to attach a simplified report on transactions with related parties to the tax return (in case of taxpayers whose revenues or costs exceed EUR 10 million).

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The draft amendments modify the current definition of related parties; under the draft, related parties are entities that possess an interest (direct or indirect) in the capital of another entity that is equal to not less than 20 percent (up from the current 5 percent).

Comments

The changes introduced by the Ministry of Finance may have a significant impact on the scope of taxpayers' responsibilities regarding preparation of transfer pricing documentation.

This is yet another sign that tax authorities have increased their interest on transfer pricing. In this context, it is worth noting the recent amendments to the Transfer Pricing Ordinance (July 2013), the explanations published by the Ministry of Finance concerning business restructuring (February 2014), the latest report by the Polish Supreme Audit Office pointing out a lack of proper control of the settlements between related parties (January 2015), the intensified preparation of tax authorities in respect of transfer pricing audits, and the organizational changes within the tax administration.

It is also important to highlight that the proposed amendments take into account the plan of actions set out in the OECD's Report on counteracting base erosion and profit shifting (BEPS), in particular action 13: "Reexamine transfer pricing documentation," and by the EU Code of Conduct on transfer pricing documentation for associated enterprises in the European Union (Official Journal of EU C of 27 June 2006).

Apart from the significant changes related to the scope of the documentation, it is important to note that documentation must be submitted in Polish (the local file, the master file, and the country-by-country report). In addition, there is a clearly stated preference for local comparables. Finally, the amendments introduce personal responsibility for local management boards/persons representing foreign entities to file each year a statement confirming the preparation of complete documentation within the statutory deadline, and filing it with the annual tax return.

The text of the draft amendments is available on the website of the Government Legislation Center.
URL: https://legislacja.rcl.gov.pl/docs//2/12271904/12286346/12286347/dokument161143.pdf

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New Zealand Releases Transfer Pricing Focus for 2015 and 2016

New Zealand's Inland Revenue Department (IRD) recently released its transfer pricing focus areas for 2015 and 2016, encompassing the full range of both inbound and outbound associated-party transactions.
URL: http://www.ird.govt.nz/transfer-pricing/enforcement/transfer-pricing-enforcement-focus.html

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The IRD's top priority will be the Significant Enterprises Segment, which comprises some 560 taxpayer groups with a reported turnover in excess of NZ $80 million, 50 percent of which is foreign-owned, with a further 25 percent involved in international operations, mainly through controlled foreign companies. The IRD note that these taxpayer groups account for over half of New Zealand's corporate tax base and 10 percent of overall tax revenue. The IRD have indicated that these companies represent the highest risk as to profit shifting given the extent of their international transactions.

The IRD will continue to refine their risk assessments of all significant enterprises through analysis of annual basic compliance packages (financial statements, tax reconciliations, and corporate structures) supplemented by transfer pricing questionnaires.

Regarding issues across all segments of the corporate population, the IRD will maintain a special focus on the following:

- Unexplained tax losses incurred by foreign-owned groups;
- Loans in excess of NZ $10 million principal and guarantee fees;
- Payment of unsustainable levels of royalties and/or service charges;
- Material associated-party transactions with no-tax or low-tax jurisdictions;
- Supply chain restructures involving the shifting of any major functions, assets, or risks away from New Zealand; and
- Any unusual arrangements or outcomes that may be identified in controlled foreign company disclosures.

The IRD also have advised that they will continue to monitor the profitability of foreign-owned wholesale distributors (firms that purchase and on-sell goods to other firms without significant transformation), which are the most common multinational business form encountered in New Zealand. For small wholesale distributors (those with under $30 million in annual turnover), they will seek explanations for any performance resulting in a weighted average profit-before-tax ratio of less than 3 percent.

Intercompany service charges – administrative practice and checklist

Administrative practice: To further minimize compliance costs for multinational enterprises, and to align with the administrative practice of the Australian Tax Office (ATO) for intercompany service charges, the IRD have raised the de minimis threshold for services from NZ $600,000 to NZ $1 million. The higher threshold applies from January 1, 2015.

The administrative practice allows taxpayers to apply a mark-up of 7.5 percent to the cost of certain non-core services and services with costs below the de minimis threshold of NZ $1 million, in the absence of a detailed transfer pricing analysis or benchmarking study. For further detail on the IRD's administrative practice for services, including the criteria for application of the administrative practice, refer to paragraphs 557-570 of New Zealand's Transfer Pricing Guidelines, noting that the de minimis threshold has not been updated in this document.
URL: https://www.ird.govt.nz/resources/2/b/2bd702004ba38793811bbd9ef8e4b077/apx12-10.pdf

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Service charge checklist: To assist companies operating internationally, including in particular a large number of New Zealand small-to-medium-sized enterprises, the IRD have compiled a checklist based on their experience in reviewing international service charges:

1. Understand the charge, go behind the label, and document it (the actual services provided, the benefits arising, the basis of the charge, etc).
2. The cost plus method is generally best, but never rule out the possibility of internal comparables (where similar services are being provided to third parties by the provider).
3. Watch out for “duplicated services” – in particular, does the enterprise have an infrastructure in New Zealand that can and does provide the type of services for which charges are also being made from overseas?
4. Be wary of charges for directors/chief executives (doing no more than investment monitoring), and overseas regulatory costs (for instance, Sarbanes Oxley compliance costs) – these are most probably non-chargeable “shareholder services.”
5. Get the cost base right (including New Zealand tax deductibility of items included in cost sharing arrangements) and apply a sanity check – does it make sense, especially in relation to the bottom line?
6. Mark-ups must be fair and reasonable in relation to the nature of the service and the risks assumed, for example:
    a. No mark-up for simply on-charging third-party costs;
    b. Minimal mark-ups for low-risk supporting services;
    c. Higher mark-ups where specialist knowhow or expertise is involved.
7. An allocation key should result in a charge proportionate to expected benefits – in this regard, turnover can be too simplistic and arbitrary (don’t just assume a close relationship between services provided and sales without further analysis).
8. For outbound direct investment/New Zealand exporters, management and other support services provided to offshore associates (including controlled foreign companies) must be identified and fully charged.
9. A branch is not legally distinct from the rest of the enterprise – service charges should therefore be allocated on an actual cost basis only (i.e., no mark-ups).
10. Keep in mind other tax obligations such as withholding on services performed in New Zealand by offshore associates and royalties (“know-how and connected services”).

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India’s CBDT Issues Clarifications on Rollback Provisions of APA Regime

India’s Central Board of Direct Taxes (CBDT) has issued clarifications on the rollback provisions of the advance pricing agreement (APA) regime in a question-and-answer format through Circular No. 10/2015, dated June 10, 2015. These clarifications are analyzed below.

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Analysis of the Circular

Applicability of APA rollback provisions: Taxpayers are entitled to APA rollbacks for years for which revised returns have been filed, provided both the revised return and the original return have been filed within the due date specified in the Income Tax Act, 1961 (ITA).

The benefit of an APA rollback is not available for years for which the return was filed late, that is, after the due date to file the original return, but within the due date for filing a belated return under the ITA.

International transactions entitled to APA rollback: The benefit of an APA rollback may be allowed for international transactions for which all the following conditions below are satisfied:

- The transactions are of the same nature and with the same associated enterprise (AE) as proposed in the APA for future years.
- An APA has been concluded for such international transactions.
- Function, asset, and risk (FAR) analysis of rollback years are not materially different from the FAR analysis agreed as per the APA.

Taxpayer cannot pick and choose the rollback year: The benefit of APA rollback is available only if the taxpayer applies for all four eligible rollback years.

An otherwise eligible APA rollback year may be excluded from applicability of the rollback only under any of the following scenarios:

- The covered international transaction was not in existence during that year.
- The taxpayer fails the rollback conditions for that year; for example, the income tax return was not filed within the specified due date, or the Income Tax Appellate Tribunal (ITAT) had passed an order disposing of an appeal regarding the covered international transaction, or application of the rollback provision would have the effect of reducing total income or increasing losses as declared in the income tax return.

Set aside of order by ITAT – APA rollback entitlement valid: The CBDT has distinguished between passing of final order by the ITAT regarding the covered international transaction (as subject matter of appeal) and setting aside the ITAT order for fresh consideration.

Setting aside the ITAT order for fresh consideration would mean that the matter did not reach finality and hence, the particular year would be eligible for application of the rollback provisions.

No reduction in the returned income due to APA rollback: Declared income in the income tax return cannot be reduced through the application of the rollback provisions.

If the impact of the application of the APA rollback provisions is that declared income is more than the computed rollback income, then declared income will be considered the final income for that rollback year.

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Cancellation of APA rollback means cancellation of entire agreement: The entire APA can be cancelled if there is any noncompliance with the requirements or conditions under the rollback provisions of the ITA, with respect to the APA rollback years.

Mutual Agreement Procedure (MAP) and APA rollback: Taxpayers may avail themselves of the APA rollback provisions if a MAP request is pending, but the taxpayer will have to choose either the APA rollback route or the MAP route. If the MAP has already been concluded for the covered international transaction, then APA rollback entitlement will not be available for that particular year (for which the MAP was concluded).

Merger and demerger cases: To validate the eligibility of the APA rollback in merger or demerger situations, the following principle will be followed:

- APA rollback entitlement is only for the legal entity that is the original APA applicant.
- For example, if A & B merge to form a new company C and C is the APA applicant, then A & B are not entitled to APA rollback. If A, the original APA applicant, demerges into B, then only A's international transactions would be entitled to APA rollback.

Other clarifications: The arm's length price arrived at for the APA rollback years may be different from that arrived for the APA term; however, the arm's length price methodology (including choice of method, comparability analysis, and tested party) will be the same.

- A compliance audit for APA rollback years will be conducted to check if the modified return contains the price and methodology as agreed to in the APA.
- Withdrawing an APA rollback application while maintaining the APA application for future years is allowed, but not vice versa. If an APA rollback application is withdrawn, there will be no refund of fees.
- For concluded APAs, finalization of rollback application will involve revision of the concluded APAs.
- The time to file a modified return for APA rollback years will start from the date of signing the revised APA incorporating the rollback provisions.

Conclusion

Through this circular, the CBDT has clarified some important taxpayer queries with respect to the application of APA rollback provisions. Providing taxpayers a choice between the MAP and the APA rollback route is a good initiative. This will enable taxpayers to settle pending litigations faster.

However, a few questions remain unanswered, including taxpayers' concerns on:

- What happens to the refund of APA rollback application fees paid by applicants who have already filed the APA rollback application, but will now be ineligible for rollback because they do not meet the conditions provided in the circular;
- Ineligibility for APA rollback if the associated enterprise of the rollback year is not the same as in the APA application (even though the FAR and the nature of the international transactions are the same);
- Applicants not entitled to APA rollback if it is requested for less than four years;

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- The applicant's right to choose the international transaction for rollback, if the APA covers more than one international transaction;
- Cancellation of the entire APA if there is any procedural lapse with respect to APA rollback years; and
- Lack of availability of rollback for merged entities even though the nature of the covered transactions and the FAR are same as that of the APA applicant.

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Bolivia Issues Transfer Pricing Ruling on Documentation Requirements

As part of the transfer pricing regime established on July 21, 2014, by Act 549 and Executive Order 2227, Bolivia's National Revenue Service on April 30, 2015, issued Board Ruling 10-0008-15, "Transfer Pricing in Transactions between Related Parties," which sets out an operational framework governing compliance with the obligations imposed on taxable persons who enter into transactions with related parties.

The ruling's scope covers all taxable persons subject to Corporate Income Tax who enter into commercial and/or financial transactions with related parties.

Transfer pricing study

The new rules provide that a transfer pricing study must be prepared, in hard copy and electronic form, written in Spanish, stated in Bolivian currency, and signed by the taxpayer's legal representative or the holder of the tax identification number (NIT), as applicable.

A hard copy of the transfer pricing study is to be filed with the tax authorities' district offices or Large Taxpayers Offices (GRACO) in the appropriate jurisdiction, together with the financial statements for the fiscal year. The electronic version of the transfer pricing study must be submitted through the National Revenue Service webpage.

Contents of the transfer pricing study

At a minimum, the transfer pricing study must include:

- An index;
- An executive summary that includes a list of the taxpayer's related parties, the nature of the relation; the transactions conducted; and the transfer pricing method selected.
- A functional analysis, with background information on related parties; a description of the organizational and corporate structure of the group; business activities conducted by the taxpayer and the markets where it operates; commercial strategies; a description of transactions, contracts, etc.
- Economic analysis: a description and quantification of transactions performed with related parties; a determination and description of valuation methods used; justification

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of the selected method; a selection of comparables and sources of comparable information; and a definition of a range.

- Conclusions.

Validation methods

The following methods are acceptable to the tax authorities:

1. The comparable uncontrolled price method;
2. The resale price method;
3. The cost-plus method;
4. The profit split method;
5. The transactional net margin method; and
6. The transparent market price method.

The new rules impose an obligation to file E-Form 601 – Information Return of Transactions with Related parties. Instructions for completing this form will be available on the National Revenue Service webpage, www.impuestos.gob.bo.
URL: http://www.impuestos.gob.bo/

The new rules establish the principle of materiality. Taxable persons who enter into transactions with related parties are required to file the following information:

1. For transactions equal to or higher than BOB 15,000,000 (approximately US $2,100,000), they must file E-Form 601 and the transfer pricing study.
2. For transactions equal to or higher than BOB 7,500,000 (approximately US $1,000,000) but less than BOB 15,000,000, they must file E-Form 601.
3. When transactions are below BOB 7,500,000, taxpayers are required to keep the necessary documentation to demonstrate that their related-party transactions were conducted at arms' length, or that the necessary adjustments were made.

Penalties

The new rules impose penalties for failure to comply with the formal requirements, specifically, failure to file or late filing of the transfer pricing study in hard copy and digital form, failure to file or late filing of the Information Tax Return on Transactions with Related Parties – E-Form 601; and submitting a transfer pricing study and Form 601 with mistakes or incomplete information.

Effective dates

This information required must be filed within the term established for the return and payment of the Corporate Income Tax, effective from the first fiscal year subject to Act 549, dated July 21, 2014.

Conclusion

The fact that specific transfer pricing requirements have been put in place will allow the tax authorities to perform automated analyses to identify potential discrepancies in the filings

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(errors, significant variations from past years, differences with peers). This will give the tax authorities a large database on flows and transfer pricing methods applied by international groups, as well as a tool to better prioritize audits.

Taxpayers should be careful when filling out the new forms and the transfer pricing report, and should consider the potential consequences of their statements. We strongly suggest that transfer pricing documentation be prepared in advance of filing the form or transfer pricing report. Indeed, having transfer pricing documentation will provide Bolivian taxpayers a full view of their transfer pricing situation, allowing them to fully anticipate and appreciate the consequences of the information provided.

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Italy's Supreme Court Rules on Interest-Free Related-Party Loans

Italy's Supreme Court recently released a decision on a transfer pricing case, ruling that a no-interest loan between an Italian parent company and its foreign subsidiaries did not violate the transfer pricing rules.

Decision no. 27087, issued on December 2014, but released on March 31, the Supreme Court addressed the issue of transfer pricing in the context of an interest-free loan from an Italian parent company to its foreign subsidiaries, and concluded that intercompany interest -free loans can be legitimate.

The judges established that, in this particular case, the arm's length standard (set forth in art. 110, paragraph 7 of Italian Presidential Decree 917/1986 ("TUIR")) should not be applied because there was no "arm's length value" of the loans to be evaluated, given that no interest was paid by the foreign borrowers. In fact, the foreign subsidiaries just had an obligation to return the borrowed capital to the Italian parent company.

The judges' approach is based on a reading of art. 110, paragraphs 7 and 9, paragraph 3 of the TUIR, according to which transfer pricing rules should be applied only if a cross-border intercompany transaction produces income components (positive or negative) and the application of the arm's length principle causes an increase in taxable income.

Indeed, as far as the Supreme Court is concerned, the aforementioned conditions "are not substantial in an interest-free loan, since the service itself is unrelated to the bargaining pattern in which interest is paid. The interest payment is the necessary condition for a comparison with 'market value'."

In other words, the judges argued that because the loans granted by the Italian parent company to its foreign subsidiaries were free of charge, no transfer pricing rules should apply, since art. 110, paragraph 7 does not require that each cross-border intercompany transaction should imply a payment; rather, it requires that, for tax purposes, the determination of the

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arm's length value, according to art. 9, paragraph 3 (as cross-referenced by art.110, para. 7) should be related only to the exchange of goods and services upon payment.

Hence, with the decision under review, the judges considered the choice of the Italian parent company to be legitimate and business-related, and not *per se* irrational. In fact, it is not possible to exclude *a priori* that the lender could obtain some specific advantages from the decision to relieve the borrower from the obligation to pay interest.

Based on the above, the Supreme Court, affirming the decision of the second degree court, rejected the appeal filed by the Tax Revenue Agency. The latter, criticizing the taxpayer's choice, challenged, under art. 110, paragraph 7 of the TUIR, the lack of any interest charge by the Italian parent company. The Tax Revenue Agency argued that it was precisely the gratuitousness of the loan(s) that underscored the advantage obtained for free by the foreign related companies. Had the subsidiaries been obligated to raise funds from the financial market, they would not have benefited from the same advantage. Therefore, the financing operation carried out by the Italian parent company should be considered not at arm's length.

According to the Supreme Court, that would not be acceptable because that conclusion would be based on a general and unsupported equalization between the gratuitousness of a loan and the irregularity of the operation. Moreover, the judges stressed that in their defensive thesis, the Tax Revenue Agency mixed up the alleged elusive purpose of granting an undue advantage/ fiscal saving (which may well represent an "abuse of Law") to the foreign related party, with the economic advantage provided by the Italian parent company to its foreign subsidiaries (which does not trigger *per se* any "abuse").

Indeed, in their explanation, the Supreme Court judges clarified that the arm's length principle, as set forth in art. 110, paragraph 7 and in art. 9, paragraph 3 of the TUIR, falls outside the framework of the abuse of law concept. Therefore, the granting of an interest-free loan does not represent improper conduct, nor an elusive action that could be equated to an abuse of law: "If the financial operation does not produce a taxable income, the constituent element of the abusive act of an undue tax savings is not present. [To that aim] This element should be an exclusive and preeminent purpose of the operation."

Finally, according to the Supreme Court, the granting of interest-free loans among related group companies did not integrate, in this particular case, any biased negotiation mechanism nor any abnormal use of the contractual framework, both of which would be symptomatic of elusive conduct. In fact, for the lending counterpart, the choice found its rationale (business reason) in the intent to optimize the available resources and maintaining market share.

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