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Global Transfer Pricing

Arm's Length Standard

December 2014

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OECD Issues Discussion Draft on Low-Value-Adding Intragroup Services

The OECD, as part of its work on the Action Plan to address Base Erosion and Profit Shifting (BEPS), on 3 November 2014 released a discussion draft in relation to Action 10 proposing a simplified transfer pricing approach for low-value-adding intragroup services that will ultimately lead to revisions in Chapter VII of the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. The goal is to reduce base erosion through excessive management fees and head office expenses, particularly in developing countries. The simplified approach, which a taxpayer group may elect to adopt, recognizes that the arm's length price is closely related to costs, allocates the costs of providing each category of such services to those group companies that benefit from using those services using consistent group-wide allocation keys with an associated consistent small mark-up.

As with other discussion drafts on BEPS Actions, the proposals do not represent a consensus view from the G20/OECD countries involved, but are designed to provide substantive proposals for public comment.

Next Steps

The proposed simplified approach to low-value-adding services will be helpful for some groups. In many instances it has proved difficult or too costly to provide sufficient evidence to

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support what may be small individual charges across a wide number of jurisdictions, leading to double taxation. In addition, the simplified approach will benefit tax authorities with limited resources in considering the appropriate mark-up. However, the proposals do not discuss a common key issue – the disparity in the costs incurred in high-cost developed countries where services are provided to low-cost developing countries, where comparable services cannot be obtained locally – and this may remain a source of disputes.

The proposed mark-up range of 2 percent to 5 percent is narrower and lower than the EU Joint Transfer Pricing Forum's guidance for similar low-value-added services (endorsed by the European Commission), which suggests that a mark-up range of 3 percent to 10 percent, depending on the circumstances, is typically found.

The simplified approach for a group that chooses to apply it will need to be applied on a globally consistent basis, which will entail:

1. A greater coordination of cost pooling and allocation of services, particularly when this is currently done on a regional basis; and
2. Additional compliance in the year of adoption to establish the appropriate cost pools, allocation keys, and documentation.

For countries with OECD-based double tax treaties, amendment to the transfer pricing guidelines will likely be sufficient to implement the proposals for simplification, but it remains to be seen whether other countries (particularly outside of the OECD) choose to adopt the proposals, and this may affect its practical application on a global basis.

A simplified approach for low-value-adding services

The discussion draft defines low-value-adding intragroup services as those that are supportive in nature, are not part of the core business of the group, do not use or create intangibles, and do not involve significant risk. The draft provides examples of qualifying and nonqualifying services. For some services, a fact-specific functional analysis will be required.

Determination of arm's length charges

Computing the charge: A group that elects to apply the simplified method should identify, on an annual basis, a pool of costs associated with categories of low-value-adding services that are provided to multiple members of its group. The cost pool should exclude costs that are attributable to an in-house activity that benefits solely the company performing the activity (including shareholder activities performed by the shareholding company, based on existing guidance). Those costs related to services performed *solely* on behalf of one other group member should be removed from the pool, as these costs and their mark-up will be charged directly.

The next step is to allocate among members of the group the costs in the pool, by selecting an allocation key dependent on the nature of the services. A consistent approach is expected – the same allocation key or keys should be applied in determining the allocation to all group companies of the same category of low-value-adding services, and the same key(s) should be used each year unless there is a valid reason to change.

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The discussion draft specifies that the same mark-up should be used for all low-value-adding services irrespective of the categories of services. It proposes that the applied mark-up should be between 2 percent and 5 percent of the relevant cost.

Supporting the charge: Usually, an obligation to pay for an intragroup service arises only when the activity provides the group member with economic or commercial value to enhance or maintain its commercial position. The discussion draft recognizes that while low-value-adding services may provide benefits to all recipients of those services, it may be difficult to demonstrate whether the recipient would have been willing to pay for the individual service from an independent party or perform it itself. A simplified benefits test is recommended, whereby tax authorities should consider benefits only by categories of services. The discussion draft suggests that a single annual invoice describing a category of services should suffice to support the charge, and correspondence or other evidence of individual services should not be necessary. Documentation should also include:

- Reasons justifying why the services meet the definition and expected benefits of each category of service;
- Description and justification of choice of allocation keys and confirmation of mark-up applied; and
- Calculations showing the determination of the cost pool and the application of the specified allocation keys.

Timetable

The OECD has invited interested parties to submit comments by 14 January 2015. A public consultation meeting on the discussion draft will be held at the OECD in Paris on 19-20 March 2015. Registration details will be published on the OECD website.

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Australian Taxation Office Issues Guidance on Australia’s New Transfer Pricing ‘Reconstruction’ Provisions

The Australian Taxation Office released Taxation Ruling TR 2014/6 on 12 November 2014, setting out the Commissioner of Taxation’s guidance on the application of section 815-130 of

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Subdivision 815-B of the Income Tax Assessment Act 1997, which is the most controversial element of Australia's new transfer pricing laws.[1]

Section 815-130 is often referred to as the 'reconstruction' provision, because it provides the Commissioner with broad powers to reconstruct actual transactions undertaken by Australian taxpayers. Such reconstruction may result in transfer pricing adjustments being made on the basis of how independent parties would hypothetically have dealt with one another, as well as when the form of actual commercial or financial relations between Australian taxpayers and their international affiliates is inconsistent with the substance of those relations.

In addition to providing guidance on section 815-130, TR 2014/6 also includes the Commissioner's views on the application of section 815-140 of ITAA 1997, which covers the interaction of Australia's new transfer pricing provisions and existing thin capitalization rules.

Key aspects of section 815-130 & TR 2014/6

Despite a lengthy consultation process during which key stakeholders voiced concerns about the practical application of section 815-130, TR 2014/6 appears to ignore the bulk of suggested changes to draft TR 2014/D3[2] and pays only lip service to others. As a result, the effect of TR 2014/6 is not materially different than that of TR 2014/D3, which it replaces.

TR 2014/6 does little to alleviate taxpayers' fears about the ATO's ability to reconstruct Australian taxpayers' cross-border related-party transactions and creates uncertainty about how and when the reconstruction provisions will apply.

In particular, the tone of TR 2014/6 does not align with that of the OECD transfer pricing guidelines'[3] sections dealing with the recognition and substitution of actual transactions undertaken. These sections of the OECD guidelines[4] make it explicitly clear that, other than in "exceptional circumstances," tax administrations should not disregard actual transactions or substitute other transactions for them. TR 2014/6 adopts a different and very wide-ranging interpretation of when the reconstruction provisions will apply.

With the finalization of ATO guidance on the reconstruction provisions, the concern from taxpayers is that these rules will encourage ATO auditors to second-guess taxpayers' business decisions. This takes us into a space fraught with guesswork, where the ATO will be hypothesizing what would have happened in the real world.

Taxpayers fear that ATO auditors will ask the question: "Why did you do it like that?," and answer it with "You could have made more profits if you'd done it like this, so that's what an independent party would have done and that's what we'll be taxing you on." There is concern regarding the tension that will arise if and when the ATO tries to tell taxpayers how to run their

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[1] As set out in Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013

[2] Released in April 2014.

[3] *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, July 2010.

[4] *See* paragraphs 1.64 to 1.69.

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businesses, bringing with it the inevitable potential for differing views, greater disputes, and unrelieved double taxation.

‘The basic rule’ in section 815-130 & exceptions

The basic rule in subsection 815-130(1) requires that the determination of the arm’s length conditions between relevant parties must be based on the actual financial or commercial relations that were in operation between those parties (similar to OECD guidance that arm’s length pricing should be based on actual transactions undertaken, except in exceptional circumstances).

TR 2014/6 acknowledges the Commissioner’s view that the basic rule is expected to apply in most cases.[5] However, under section 815-130, the basic rule applies only to the extent none of the following three exceptions apply:

1. The form of the actual commercial or financial relations is not consistent with their substance;
2. Independent parties in comparable circumstances would not have entered into the actual commercial or financial relations and would have instead entered into other commercial or financial relations that differ in substance from the actual commercial or financial relations; or
3. Independent parties in comparable circumstances would not have entered into commercial or financial relations at all.

“Form” versus “Substance”

The “form” of the commercial or financial relations describes the features of the legal relationship or legal characteristics of the dealings between entities. The “substance” of the commercial or financial relations is defined by TR 2014/6 as “the economic or commercial substance, or economic reality or essence of those relations.”[6] In Appendix 1 to TR 2014/6, the Commissioner acknowledges that the meaning given to the term “substance” under Subdivision 815-B should be consistent with the OECD transfer pricing guidelines.

In determining the substance of the commercial or financial arrangements, TR 2014/6 considers various factors[7] as relevant, including “whether the relations make commercial and financial sense in all of the circumstances – that is, do they provide a commercially realistic return for the functions performed, assets used and risks assumed or managed in the relevant business activities, and are not contrary to the commercial interests of the parties.”[8]

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[5] *See* paragraph 40 of TR 2014/6 and paragraph 3.98 of the Explanatory Memorandum to Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013, which accompanied the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013.

[6] *See* paragraph 90 of TR 2014/6 and paragraph 3.84 of the Explanatory Memorandum.

[7] *See* paragraph 109.

[8] Id.

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There is some concern regarding the scope of the factors to be considered in looking at substance. In particular, TR 2014/6 appears to pave the way for the ATO to reconstruct transactions that, in the ATO's view, do not provide a "commercially realistic return" (that is, a level of profit acceptable to the ATO), on the basis that those transactions have no substance.

Interaction with thin capitalization provisions

TR 2014/6 confirms that Section 815-140 requires an arm's length interest rate on inbound intragroup debt to be applied to the debt actually issued, rather than to the arm's length amount of debt – though this arm's length debt amount is important in determining the applicable interest rate.

TR 2014/6 implies that the Commissioner may challenge debt that has been priced in an arm's length manner, when the taxpayer is not regarded as being sufficiently profitable.

ATO activity since TR 2014/6 was released

We understand from recent discussions with senior ATO personnel that:

- In association with TR 2014/6, the ATO is preparing a practice statement law administration (PSLA) that will require the approval of an ATO officer's senior executive prior to the use of section 815-130 by the ATO. The practice statement will further require that senior executive to consult with the International division of the ATO before agreeing to the use of 815-130.
- The ATO is now merging its April 2014 draft tax ruling and associated draft PSLA on transfer pricing documentation[9] into a single taxation ruling, with a view to providing more practical, principle-based guidance, and to being less prescriptive and process-driven. The new ruling will include guidance on documenting analysis regarding the three exceptions in the transfer pricing reconstruction provisions. In this regard, the ATO intends to outline a relatively simple way of documenting how the exceptions don't apply when the basic rule does apply.

While these initiatives are welcome, taxpayers will need to see and assess the details of the new PSLA and tax ruling before concluding that the concerns raised by section 815-130 and TR 2014/6 have been alleviated. We understand from the ATO that the ruling will be issued in final form, and that the ATO is working toward a release date of 17 December 2014.

What should taxpayers do in response to sections 815-130 & 815-140?

Section 815-130 is a wide-ranging and uncertain provision, and taxpayers need to be mindful when implementing, analyzing, and documenting their transfer pricing arrangements that the section's requirements for reconstruction are not met. Importantly, taxpayers should be aware that the reconstruction provisions can apply to arrangements implemented before the provisions' introduction, if relevant arrangements affect an Australian tax position in a year covered by the new transfer pricing rules.

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[9] TR 2014/D4 and PSLA 3673.

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With Australia's transfer pricing rules being brought into the self-assessment regime, the reconstruction provisions are not reserved for just the ATO to apply. Accordingly, taxpayers need to prepare and maintain documentation to demonstrate that they have addressed the steps involved in applying section 815-130 in relation to all of their international related-party transactions. This imposes additional – and potentially significant – compliance obligations on taxpayers, beyond those required under the previous transfer pricing rules in Division 13 of the Income Tax Assessment Act 1936.

In addressing sections 815-130 and 815-140 ITAA 1997, taxpayers should:

- Ensure pricing policies with international affiliates reflect the underlying substance of the parties' commercial or financial relations, and that such relations are consistent with those that would have been entered into by independent entities in comparable circumstances.

- Undertake and document regular reviews confirming whether their operating models are consistent in practice with the form of their legal arrangements, and evaluate and document what independent parties would have done in similar circumstances. The reconstruction provisions do not require related parties to choose options that have the highest tax outcomes, but the commercial thinking behind why such options were considered and rejected should be documented.

- In relation to inbound, intragroup debt, prepare and maintain documentation to demonstrate that section 815-140 has been appropriately applied (supporting both the arm's length quantum and pricing of inbound intragroup debt). This will require a detailed analysis of intragroup loans' terms and conditions.

  In relation to the application of section 815-140, it is difficult to see how a taxpayer would determine the arm's length conditions without having to determine an arm's length amount of debt, which adds another layer of complexity in determining an arm's length interest rate for loan transactions.

- Consider preparing Reasonably Arguable Position (RAP) papers on the application of the reconstruction provisions to transactions with material transfer pricing risks – for example, significant business restructures (especially when they lead to lower profits and tax in Australia) and material financing transactions. In addition to supporting transfer pricing filing positions, these RAP papers may also assist in relation to tax provision work – particularly if the existence of uncertain tax positions is required to be considered.

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Greece Issues Templates and Guidelines for APA Negotiations

In an effort to provide taxpayers with an integrated procedural framework for the negotiation of advance pricing agreements (APAs), the Greek Ministry of Finance on 16 October 2014 released template application forms for both preliminary consultations and formal negotiations, as well as additional guidelines on the overall APA procedure.

The forms and guidelines are available (in Greek) at the ministry's website.
URL: http://www.publicrevenue.gr/kpi/public/archive/1161

Application Form for Preliminary Consultation

Based on the template the ministry released, the Application for Preliminary Consultation, which is optional for taxpayers, must include the following data:

- The applicant's data (name, tax identification number, and supervising tax office);
- The type of advance pricing agreement requested – unilateral, bilateral, or multilateral – with specific reasoning when a unilateral APA is requested;
- The period during which the requested APA will apply;
- Proposed date(s) of the preliminary consultation meetings with the tax authorities; and
- Information regarding the persons that will represent the taxpayer at the consultation.

In addition, the applicant must attach to the application (or make available during the preliminary meeting) other necessary data, including:

- Organizational/legal/functional structure of the group;
- Data of the related parties involved in the transactions covered by the APA;
- A brief description of the taxpayer's business model; and
- A brief description of the activities and transactions concerned with reference to the contribution of each party involved and an estimation of the transactions' total value.

Furthermore, the application must include:

- A functional and risk analysis of each party involved in the transactions;
- Copies of the underlying agreements;
- A copy of the tax audit report, if the transactions were audited for previous fiscal years and an act of assessment was issued;
- The proposed method for pricing the aforementioned transactions, and why the proposed method is the most appropriate one;
- Critical assumptions on which the application of the above pricing method is based;
- The criteria to be used in the comparable search process and any relevant adjustments to achieve greater comparability;
- The mechanism for performing price adjustments to comply with the arm's length principle; and
- Reference to any APAs that have been concluded by any of the related parties, either in Greece or abroad, for the same or similar transactions.

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The filing of the application for preliminary consultation requires the payment of a €1,000 fee. A copy of a document evidencing payment must be attached to the form.

Application form for the official negotiations

Based on the template the ministry released, the application form for official APA negotiations requires, to a great extent, similar information to that submitted for the preliminary consultation. This form, however, calls for a more detailed analysis of the most significant aspects of the application.

This application must include:

- The applicant's data (name, tax identification number, and supervising tax office);
- The type of APA requested – unilateral, bilateral, or multilateral;
- If the application requests a bilateral or multilateral APA, whether an application has already been filed with the pertinent foreign tax authorities, and if so, the date of filing or the estimated date of filing;
- The name of the related parties involved in the transactions covered by the APA;
- The period for which the requested APA will apply; and
- Information regarding the persons that will represent the taxpayer at the consultation.

Additionally, the taxpayer should attach to the application information that is also required for the preliminary consultation, such as the structure of the group, the data of the related parties involved in transactions, a presentation of the taxpayer's business model, as well as the following information:

- A detailed description of the activities and transactions covered by the application with reference to the contribution of each party involved and an estimate of the total value of those transactions;
- Reference to the taxpayer's other transaction flows (in terms of volume and price) that may have an impact on the pricing of the transactions concerned;
- An industry and market trends analysis;
- A comparative analysis that includes, in addition to a detailed analysis of the taxpayer's functions, assets, and risks, the business strategies of the parties involved, copies of the statutory auditor's reports for the last three years, the pertinent financial statements, copies of the corporate income tax returns for the last three years, as well as a copy of the tax audit report for prior years (in case the transactions concerned also existed in prior years). In addition, the application should include financial data for the transactions concerned for the last three years per product line, unit, and geographic region, copies of relevant market studies (if available), and copies of the relevant agreements (if available).
- Analysis of the taxpayer's transfer pricing policy, which includes the proposed transfer pricing method and a detailed reasoning for its selection, criteria for selecting comparable data and adjustments proposed to achieve comparability, critical assumptions on which the proposed method is based, the mechanism for applying the proposed methodology, and the intercompany pricing policies and practices used by the taxpayer and related parties to the transactions covered by the APA for the last three years.

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The filing of the APA application requires a €5,000 fee for unilateral APAs and €10,000 per country involved in the case of bilateral or multilateral APAs. A copy of a document evidencing payment must be attached to the form.

General guidelines

The guidelines are further proof of the importance the Greek tax authorities accord to the newly introduced procedure for APA negotiations. APAs are defined in the guidelines as agreements between one or more taxpayers and tax administrations (unilateral, bilateral, or multilateral APA) whose aim is the advance discussion of the pricing of intercompany transactions, so that compliance with the arm's length principle is achieved and double taxation is avoided. The objective is to provide taxpayers, through the APA, with greater certainty as to their transfer pricing positions and to render the audits performed by the tax authorities more efficient.

The guidelines discourage to some extent the use of unilateral APAs, because they do not eliminate the risk of double taxation, especially if there is no income tax treaty between Greece and the other contracting party's country of residence. The guidelines also stress that a unilateral APA concluded with a foreign tax authority is not binding on the Greek tax authorities.

The guidelines also clarify that in case a bilateral or multilateral APA is required, the parties involved in the negotiation are only the tax authorities of the countries involved, not the taxpayer or its related parties; the latter are notified only of the final outcome of the negotiations between the tax authorities, and they may either accept or reject the proposed agreement.

The guidelines recommend strongly that taxpayers take advantage of the preliminary consultation phase, because it gives both the taxpayer and the tax administration the chance to discuss in a less formal manner the potential benefits, the steps to be followed, and the elements needed for the conclusion of the APA and the relevant timetable. The guidelines also clarify that data submitted during the preliminary consultation phase need not be submitted again for the official negotiations.

The fact that a taxpayer may be under tax audit does not prevent it from applying for an APA, because the procedure applies only to future transactions. Moreover, the filing of an APA application will not suspend a tax audit that is already in progress.

As regards the purely procedural part, an APA application is filed with the Directorate of Audits of the Ministry of Finance (General Secretary of Public Revenue), copying also the Directorate of International Economic Affairs. In the case of a bilateral or multilateral APA, a corresponding application should be submitted to the foreign tax authorities and a copy of this filing should be submitted to the Greek tax authorities within one month. All supporting data for the application should be submitted in a mutually agreed format, and in the Greek language.

In the case of bilateral or multilateral APAs, the Greek tax authorities will inform the taxpayer on the progress of the negotiations. If the foreign tax authorities reject the application, the process is terminated and the taxpayer is notified. If the tax authorities reach an agreement,

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the taxpayer is notified accordingly and is asked to sign an APA acceptance letter, if it agrees with the outcome of the negotiations. The Greek tax administration will issue a decision on the APA application within 20 days from the signing of the acceptance letter.

The guidelines emphasize that the APA procedure requires cooperation between the taxpayer and the tax administration. In this context, and in order for the tax authority to evaluate the proposed transfer pricing policy, it should have access to all relevant data and information (of an accounting nature or otherwise). Furthermore, the guidelines grant the officers of the Directorate of Audits the right to visit the taxpayer's premises, with its consent, to verify its operating conditions.

The taxpayer may not invoke the confidential nature of a requested document as a reason for not providing it to the tax authorities. The tax administration is bound by the rules of confidentiality and cannot disclose the information received to any third party, except for the tax authorities of the other countries involved in the APA procedure.

The APA is valid from the date agreed to by the parties involved, and its duration cannot exceed four years. The APA cannot apply to a fiscal year preceding the date of the application. Following conclusion of the APA, the taxpayer is obligated to submit an annual compliance report demonstrating that it has complied with the terms of the APA. If the annual compliance report is not filed, the APA is cancelled from the fiscal year for which no annual report was filed and onwards.

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Mexico's SAT Issues Regulations on Deductions Under Shared Expense Agreements

Mexico's Tax Administration Service (SAT) published regulations on 16 October 2014 that allow expenses incurred on a pro rata basis with nonresidents to be deductible if certain requirements are met, despite a specific provision to the contrary in the Income Tax Law (ITL). These regulations put into effect the decision issued by the second chamber of the Supreme Court on 19 March 2014, in which the court held that the provision in the ITL could not be justified because Mexico's transfer pricing rules require taxpayers to adjust their transactions with related nonresident parties to arm's length terms.

Under the new regulations, the ITL provision disallowing the deduction of shared expenses with nonresidents will not apply if a Mexican company complies with the requirements in the regulations.

In addition to the general deductibility requirements included in the published regulations (the expenses must be necessary for the company to carry out its activities; there must be a justifiable connection between the expenses incurred and the benefit received, or expected to be received, by the company; if the expenses were incurred between related parties, the

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taxpayer must demonstrate that the allocation was agreed upon at arm's length terms, etc.), transfer pricing documentation must be maintained for prorated expense transactions between related parties.

The following requirements in the published regulations must be met to certify there is a reasonable relationship between the expenses incurred and the benefit received, or expected to be received, by the taxpayer that incurred the expenses:

- Each party to the shared expense agreement must have access to the details of the transaction, how the anticipated profits will be determined, the prorated expenses incurred, and the profits received.
- The participants must be companies that will mutually benefit from the agreement.
- The agreement must specify the nature and scope of the benefits that will be available at a global and an individual company level with respect to the expenses incurred and prorated among the members of the group.
- The agreement must provide for prorated expenses using an allocation method that reflects the expenses in relation to the anticipated profits.
- The agreement must specify the scope of the transactions covered and the term of the agreement.

The following transfer pricing documentation must be retained for each transaction; otherwise, the expenses will not be deductible:

- Name, country of incorporation and tax residence, country where the company has its management headquarters, tax domicile, and tax ID number of each related party involved in the prorating of global expenses or that will benefit from the prorating;
- Description of the transactions and the terms of the agreement;
- Functions and activities performed by each party, as well as the risks assumed and assets used by each party;
- Documentation supporting the global expenses incurred;
- Details and documentary evidence that the expenses were paid and prorated per the agreement;
- Documentation demonstrating that the transactions were carried out on arm's length terms and the transfer pricing method used;
- Documentation showing how comparables were determined for each transaction; and
- Supporting documentation regarding future transactions, projections used as a basis for calculating pro rata expenses and expected benefits, as well as pro rata expenses effectively incurred and benefits effectively received.

The issuance of the regulations should be welcomed by international groups, because historically they have been unable to deduct an allocation of shared expenses that benefit their Mexican operations, and they may have been discouraged from challenging this treatment through the Mexican tax court system due to the time and cost involved in litigation. Under the new regulations, these groups will be able deduct an appropriate portion of allocated expenses benefiting their Mexican operations, provided they comply with the detailed tax and transfer pricing requirements.

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Multistate Tax Commission Hears From Firms on Transfer Pricing Project

The Multistate Tax Commission's (MTC's) Arm's-length Adjustment Service Advisory Group held a two-day conference in Atlanta, Georgia on October 6 and 7 to meet with transfer pricing firms and discuss the MTC's project to develop a multistate transfer pricing service.

On the first day of the conference, seven economic firms specializing in transfer pricing presented to and fielded questions from the Advisory Group. While project facilitator and former MTC Executive Director Dan Bucks made clear that these presentations were not part of a procurement process, the state participants' discussions and the preliminary draft design show that some combination of contracted assistance from transfer pricing firms and/or direct employment of economists on the MTC staff is currently being considered.

On the second day of the conference, the Advisory Group discussed their observations based on the presentations and a preliminary draft design for an arm's length adjustment service, which Bucks had prepared in advance of the conference.

The Advisory Group is currently working toward a goal of approving a draft service design by mid-November 2014 for initial review by the MTC Executive Committee in December 2014. The Advisory Group's next scheduled meeting is a teleconference on November 3. This alert provides background on the MTC transfer pricing project, summarizes issues and ideas discussed during the conference, and suggests additional considerations.

Background on MTC Transfer Pricing Project

Many states have the ability to evaluate and potentially challenge intercompany transfer pricing arrangements through arm's length statutes and regulations similar to IRC §482, including the Treasury regulations thereunder. In addition, states may have statutes providing discretionary authority to adjust income, statutes requiring the add-back of certain intercompany payments, and statutory or judicial economic nexus principles. However, state taxing authorities have had varying levels of success challenging and litigating transfer pricing arrangements. The MTC transfer pricing project came about in an effort to enable states to pool resources to support arm's length issues on audit and during litigation. States are considering transfer pricing not only in the context of interstate transactions, but also within international transactions that may already be subject to Internal Revenue Service scrutiny. States have not typically challenged international related-party transactions on transfer pricing grounds. However, as international tax structures come under increasing scrutiny from various authorities at the international level (e.g., the Organization for Economic Cooperation and Development's Base Erosion and Profit Shifting project), some states have started to consider taking their own action. For instance, several states have in recent years begun enacting "tax haven" provisions that bring the tax

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base of a foreign entity doing business in some overseas jurisdictions into a combined report.[10] Some states have also increased challenges to US-foreign intercompany debt structures that otherwise passed IRS muster. Discussions at previous Advisory Group meetings indicate that states are now considering using transfer pricing principles to audit international structures.

The Advisory Group held its first in-person meeting on June 2, and a second in-person meeting on July 28. One area of interest at these meetings and other teleconferences was how the states may obtain cost-effective joint economic expertise. The October conference was set up, in part, to hear from firms that could provide outside economic expertise.

Nine jurisdictions have officially committed seed money to the project: Alabama, the District of Columbia, Florida, Georgia, Hawaii, Iowa, Kentucky, New Jersey, and North Carolina. However, attendance at project meetings has not been limited to these states. For example, representatives from other state taxing authorities that have not officially committed, including Connecticut and Pennsylvania, attended the conference.

Economics Firm Presentations[11]

On the first day of the conference, the Advisory Group heard presentations from seven economic firms specializing in transfer pricing: Chainbridge Software, LLC; Economic Analysis Group; Peters Advisors; NERA Economic Consulting; Economists Incorporated; RoyaltyStat; and WTP Advisors. The firms encompassed a broad spectrum in terms of size, background, and level of experience with state-specific transfer pricing and related issues, and typical client base (taxpayer or taxing authority). Several firms had generally focused on federal transfer pricing issues but indicated that they would be available to support the MTC on state transfer pricing issues.

The firms were asked to frame their discussion around several previously circulated questions that focused on ways to improve taxpayer compliance, the types of services the firms could provide to the MTC, how the MTC might best integrate economic expertise, and what lessons the states might learn from other taxing authorities.[12]

The firms discussed transfer pricing broadly, as well as recommendations as to how the MTC might proceed. All the firms indicated they could support the MTC or individual states in some way. Rather than summarize each firm's presentation, in this alert we highlight a few themes and ideas that spurred discussion among the participating states.

The general theme among presenters was that getting the right information at the right time would be of critical importance for the success of a transfer pricing audit. Several firms

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[10] See, e.g., Alaska Stat. § 43.20.145(a)(5); D.C. Code Ann. § 47-1810.07(a)(2)(F)(i); Mont. Code Ann § 15-31-322(f); Or. Rev. Stat. § 317.715(2); R.I. Stat. 44-11-4.1(d); W. Va. Code § 11-24-13f(a)(7).

[11] Copies of the presentations are available at the project website: http://www.mtc.gov/The-Commission/Committees/ALAS.

[12] For a complete list of the questions, *see Draft Issues for October 6 Conference: Item III.B for July 28 Meeting*, Dan Bucks, Project Facilitator (July 25, 2014). http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Events/ALAS_Advisory_Group/Memorandum%20on%20Draft%20Issues%20for%20October%206%20Conference.pdf

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suggested requiring detailed disclosure and reporting of intercompany transactions on taxpayers' state tax returns. One suggested imposing penalties for failure to meet those disclosure requirements. Several firms also suggested the possibility of a state-by-state version of the country-by-country reporting the OECD has included in a revised version of its transfer pricing guidelines. This would include reporting elements such as the allocation of profits, taxes paid, and indicators of economic activity on a state-by-state basis, as opposed to a country-by-country basis.[13] Several firms also discussed the importance of developing appropriate standard information document requests (IDRs), or in certain cases, tailoring IDRs once a transfer pricing audit candidate has been identified. Such requests would include obtaining a taxpayer's complete transfer pricing file, not just a transfer pricing report. Many state taxing authority participants agreed there is a need for both tax return disclosures and effective data requests, and that uniformity in those areas may yield the most effective results.

Several firms discussed how they could use training to equip auditors for gathering information, identifying transfer pricing audit candidates using risk indicators, and performing non-economic analysis (for example, making sure chosen comparables meet the identified criteria). With regard to identifying audit candidates, there was a general view among many of the state taxing authority participants that they may already know which businesses could be chosen for a transfer pricing audit, but they don't currently have the resources or expertise to conduct those transfer pricing audits. On that point, it was noted that North Carolina has as many as 150 transfer pricing audit candidates in the queue as of the date of the conference.

Several firms discussed the tools states have in addition to IRC §482-like powers, particularly statutory add-back provisions. One firm went as far as to say that transfer pricing expertise might be most effectively employed in determining the amount of intangible expense indirectly included in the cost of a tangible good (i.e., embedded royalties). The firm used an example of a good sold by a foreign related manufacturer to a US distributor that cost $7 with an embedded intangible cost of $2. Auditing the overall price of the good, the firm argued, might yield some change at the margins, such as reducing the price from $7 to $6. However, the firm argued, if the state successfully asserted that the entire $2 embedded royalty was subject to the add-back, this would achieve a more favorable result for the state. While many states may have statutory authority to add back embedded royalties, the firm indicated that those amounts may not necessarily be broken out in a transfer pricing study that does not take into account state tax laws.

Several firms suggested that the state taxing authorities should consider adopting regulations that express their legal authority to challenge intercompany transactions (if not explicit in the statute) and what standards the state taxing authorities would use to analyze intercompany transactions. Several state taxing authority participants agreed that this idea warranted further consideration as part of the project.

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[13] For background on country-by-country reporting *see* the OECD's *Guidance on Transfer Pricing Documentation and Country-by-Country Reporting* (Sep. 16, 2014).

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Draft Design for MTC Arm's Length Adjustment Service

On the second day of the conference, the Advisory Group discussed a preliminary draft design for an arm's length adjustment service, which Bucks had prepared in advance of the conference.[14]

The draft provides for a four-year charter period and commitment from the states. It would provide for a mix of hired staff, including hiring one senior economist and several junior economists on the MTC staff, as well as contracts with one or more third-party economic firms. The draft calls for these resources to be used to perform transfer pricing reviews – either reviewing taxpayer-provided transfer pricing studies or conducting their own transfer pricing studies – as well as training "front-line" auditors. This training would focus on the basics of transfer pricing, selecting taxpayers for transfer pricing audit, gathering appropriate information, and doing non-economic analysis that can be supplemented by economists. The draft also outlined procedures for information sharing and cooperation among the states, and estimates of the costs of the program.

The preliminary draft is a step toward the Advisory Group's goal of submitting a draft service design to the MTC's Executive Committee in mid-November for its December meetings. The timeline calls for an ultimate goal of submitting a project design for full MTC approval in July 2015, with implementation shortly thereafter if approved.

In discussing the draft design, more than one state taxing authority participant expressed a desire to have flexibility in the operation and staffing of the project. Several also agreed on the need to articulate a business case for the project, including some "rough numbers" on the type of returns any audits might generate (whether through settlements or increased compliance).

Considerations

While the MTC's joint effort on transfer pricing is still in the development process, the conference and earlier meetings have shown that many states have identified a desire to effectively audit and address interstate and international transfer pricing issues. With that in mind, taxpayers may wish to consider:

- Developing state-relevant, exam-ready transfer pricing documentation to the extent such a study has not been previously prepared; and
- Conducting a review of any existing transfer pricing studies to determine whether an update is advisable, given any changes to the taxpayer's business activities, or whether such studies need to be adapted to take into account state laws, such as statutory add-backs, in particular with respect to the pricing of goods that could be perceived as including an embedded royalty, as well as penalty provisions.

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[14] *See Draft Design for an MTC Arm's-Length Adjustment Service*, Dan Bucks, Project Facilitator (Oct. 3, 2014).
http://www.mtc.gov/getattachment/The-Commission/Committees/ALAS/2014-10-03-DRAFT-Design-for-MTC-ALAS.PDF.aspx
http://ow.ly/FoUxi

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Bangladesh's New Transfer Pricing Rules Enter into Effect

Transfer pricing provisions in Bangladesh, effective from 1 July 2014, require taxpayers to comply with contemporaneous transfer pricing documentation requirements for cross-border transactions with associated enterprises, and to ensure that these transactions are made on arm's length terms.

Transfer pricing rules that were included in Finance Act, 2012, inserted a new chapter incorporating transfer pricing provisions into the Income Tax Ordinance, 1984. Those provisions contained various definitions for terms such as associated enterprise and international transaction, and provide rules for the computation of an arm's length price by the tax officer, referrals to the transfer pricing officer (TPO) to determine the arm's length price, maintenance of documentation, furnishing of an accountant's report, and penalties for noncompliance. The National Board of Revenue (NBR) simultaneously issued amendments to the Income Tax Rules, 1984, dealing with transfer pricing methods, the most appropriate method, factors to be taken into account for judging comparability, a list of documents to be maintained, and the form for the accountant's report.

The 2012 amendments to the ordinance stated that the transfer pricing provisions would come into force from the date specified by the NBR through a notification in the official gazette. The NBR has issued a notification making these provisions effective from 1 July 2014.

Highlights of the transfer pricing provisions include:

Associated enterprise: The definition of an "associated enterprise" in the ordinance is comprehensive and includes the following relationships:

- Direct or indirect participation in the management/control/capital of an enterprise;
    - Direct or indirect holding of shares carrying more than 25 percent of the voting power in the enterprise;
    - Cumulative borrowings of more than 50 percent of the book value of total assets of the borrowing enterprise;
- Cumulative guarantees of more than 10 percent of the book value of total borrowings of the other enterprise;
    - Power to appoint more than 50 percent of the board of directors/members of the governing board of an enterprise;
    - Practical ability to control the decisions of the other enterprise; and

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- Certain other relationships of mutual interest that would connect enterprises, which may be prescribed.

Computation of arm's length price: The arm's length price in relation to an international transaction is determined by applying the most appropriate method or methods from the six transfer pricing methods prescribed in the ordinance: the comparable uncontrolled price, resale price, cost plus, profit split and transactional net margin methods, or, if application of these methods is not reasonably possible, any other method that yields consistent results.

Documentation and accountant report: Taxpayers that have entered into an "international transaction" are required to maintain prescribed documentation if the aggregate value of the international transactions in the income year exceeds BDT 30 million (approximately USD 380,000). Taxpayers that have undertaken international transaction(s) exceeding this threshold also are required to furnish a report from a chartered accountant in a prescribed form and manner on or before the relevant deadline.

Referrals to transfer pricing officer: With prior approval by the NBR, the tax officer may refer the determination of an arm's length price to the TPO, and with the NBR's approval, the TPO may determine the arm's length price in relation to "any international transaction."

Audits and penalties for noncompliance: The ordinance contains a specific procedure for a transfer pricing audit. The audit process begins with the regular scrutiny assessment, followed by an appeal to the Commissioner of Tax (Appeal), an appeal to the Tax Appellate Tribunal, and an appeal to the higher courts (if necessary).

The penalty for failure to keep, maintain, or furnish transfer pricing documentation may not exceed 1 percent of the value of each international transaction. The penalty for failure to furnish a report from a chartered accountant may not exceed BDT 300,000.

Comments

- The most appropriate transfer pricing method must be evaluated in each case, because the ordinance does not prescribe a hierarchy of methods.
- Use of prior-year data is permitted for the comparability analysis, provided such data contains facts that may affect the analysis.
- The provisions are silent on whether a single arm's length price is allowed, or whether a range concept is preferred. No guidance is provided with regard to the determination of an arm's length price when more than one comparable price is available.
- Guidance is needed on how taxpayers should gather information related to comparable data or local companies for computing the arm's length price.
- Although not explicitly provided in the ordinance, use of a mutual agreement procedure also is available as a possible dispute resolution route for most treaty countries.
- The documentation requirements largely are based on the OECD transfer pricing guidelines and the UN transfer pricing practice manual.

Affected taxpayers should monitor and document intercompany transactions with associated enterprises from 1 July 2014 onward and ensure that these transactions are on arm's length terms, consistent with the ordinance.

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Transfer Pricing: Year-End Action Items to Address Risk of Controversy, Double Taxation, and BEPS

As year-end approaches for calendar year taxpayers, several transfer pricing issues should be considered. Failure to address these issues may result in an increased risk of transfer pricing controversy and potential double taxation:

- Competent authority notifications;
- Pre-year-end evaluation of intercompany pricing;
- Ensuring the correct implementation of year-end intercompany transactions; and
- The OECD's Base Erosion and Profit Shifting Action Plan.

Competent Authority Notifications

Transfer pricing continues to be the top enforcement priority of tax authorities around the world, and one of the major risks for many multinationals. With foreign tax authorities aggressively asserting transfer pricing deficiencies, many taxpayers are receiving proposed adjustments regarding intercompany transactions. For this reason, it is imperative that taxpayers understand the actions required to preserve the right to request competent authority assistance to relieve double taxation.

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

In 2013, 82 percent of new cases related to foreign-initiated adjustments. Given the ever-increasing aggressiveness of foreign tax authorities, taxpayers must be increasingly vigilant regarding the treaty deadlines to protect the right to request competent authority assistance. These treaty deadlines can and do differ from domestic statutes of limitations, and taxpayers must take protective actions to keep recourse to competent authority open. The fact that the

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domestic statute of limitations may still be open for transfer pricing assessments in one or both of the affected countries is not determinative of the availability of competent authority assistance.

We strongly recommend that taxpayers that are either subject to a foreign tax audit, or that have a reasonable expectation that they may be subject to a foreign tax audit, review the relevant treaty timelines and take all necessary protective measures. Taxpayers do not need to wait until the conclusion of a transfer pricing audit to take such measures.

Failure to notify the IRS (or foreign tax authority) within the specified time frames will likely preclude the taxpayer from seeking competent authority relief from double taxation, and may also give rise to issues regarding the creditability of foreign taxes. *See Procter & Gamble Co. v. US*, (S.D. Ohio, Case No. 1:08-cv-00608, defendant's motion for summary judgment granted 7/6/10).

The table below summarizes the notification/action requirements and applicable time limitations for requesting competent authority assistance between the United States and all of its current treaty partners. Many treaties require notification to the tax authority that did not propose the adjustment within a certain number of years of the taxpayer's tax year end or the filing of a tax return. Please note that the statute of limitations for a tax adjustment may extend past the due date for notification under the US-Mexico tax treaty. Consequently, we strongly advise taxpayers to file notifications with the IRS APMA program at the onset of any Mexican tax examination.

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

US Treaty Partner	Notification/Action Deadline per Treaty
Australia	The case must be presented within three years from the first notification of the tax authority action giving rise to taxation not in accordance with the provisions of the treaty.
Austria	No deadline.
Bangladesh	No deadline.
Barbados	No deadline.
Belgium	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Bulgaria	No deadline.
Canada	The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within six years from the end of the taxable year to which the case relates.
China	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Cyprus	No deadline.
Czech Republic	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.

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

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US Treaty Partner	Notification/Action Deadline per Treaty
Malta	No deadline.
Mexico	The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within four and a half years from the due date or the date of filing of the return in that country, whichever is later.
Morocco	No deadline.
Netherlands	The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within six years from the end of the taxable year to which the case relates.
New Zealand	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Norway	No deadline.
Pakistan	No deadline.
Philippines	No deadline.
Poland	No deadline.
Portugal	The case must be presented within five years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Romania	No deadline.
Russia	No deadline.
Slovakia	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Slovenia	The case must be presented within five years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
South Africa	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty (or in the case of tax collected at source, within three years from the date of collection).
Spain	The case must be presented within five years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Sri Lanka	No deadline.
Sweden	No deadline.
Switzerland	No deadline.
Thailand	The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the treaty.
Trinidad and Tobago	No deadline.
Tunisia	No deadline.
Turkey	The competent authority of the country that did not propose the adjustment must receive notification that such a case exists within five years from the end of the taxable year to which the case relates.

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

Pre-Year-End Evaluation of Intercompany Pricing

Taxpayers should be encouraged to review their transfer pricing for compliance and consistency with their transfer pricing policies prior to year-end so that any necessary adjustments to transfer pricing can be implemented on a timely basis. Although US transfer pricing regulations permit taxpayers to make some adjustments to their transfer pricing policies on a timely filed federal tax return, many foreign tax authorities do not. In some instances, the foreign tax authorities may aggressively examine such post-year-end adjustments or treat them as voluntary double taxation and deny competent authority relief. Taxpayers should consult their transfer pricing advisors to avoid such situations.

Year-end transfer pricing adjustments can also generate additional customs, indirect tax, or withholding tax implications. Doing the adjustments without considering those implications can result in automatic fines or penalties.

Ensuring Correct Implementation of Intercompany Transactions

Taxpayers should be reminded of the importance of ensuring that any new intercompany transactions or changes to transfer pricing policies be properly implemented in their books and records, including drafting or revising intercompany agreements as necessary. Taxpayers who do not do so may have difficulty supporting such new transactions or changes to their transfer pricing policies upon examination.

BEPS Initiative

The OECD’s BEPS initiative, launched in 2013, is likely to have a significant impact on the way taxpayers address their transfer pricing obligations in upcoming years. Prompted by the guidance on transfer pricing documentation and country-by-country reporting issued by the OECD on September 16, documentation rules are likely to go through their most significant change since the publication of the US documentation rules in 1994. The new rules will require new information to be collected and to be presented in new formats, and the cost of compliance will inevitably increase. The new rules will also substantially increase transparency, and inconsistent transfer pricing policies or ineffective implementation of those policies will become more evident. In addition, the new rules are likely to substantially increase global controversy.

In the near term, taxpayers should strive to understand the additional issues and challenges that are likely to be raised as a result of increased transparency, and decide if any changes to

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their transfer pricing policies are necessary to address these issues and challenges before the new rules become effective. Taxpayers should also determine whether they might need additional budget to properly address the new issues, and establish processes and procedures necessary to implement and monitor the company`s transfer pricing policies in the new world of increased transparency.

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Korea Adopts Simplified APA Program, Improves Communications with Inbound Taxpayers

Korea’s National Tax Service will introduce a simplified APA program in 2015 to alleviate the burden of tax audits for inbound taxpayers, particularly small and medium-sized ones. In a press release dated November 6, the NTS announced the new APA program as one of several measures to address and resolve tax administration issues faced by inbound taxpayers. According to the press release, the newly announced measures were the result of discussions held during a series of meetings between NTS representatives and inbound businesses in 2014 on the topic of tax administration support for foreign companies in Korea.

Simplified APA Program

A highlight of the new simplified program is the shortened time window for conclusion of an APA. Under the simplified program, APA applications will be approved within a year. A simplified APA program applicant will need to submit a reduced amount of information in the APA package. The main features of the simplified APA program are:

1. Applicant must have an annual revenue of 50 billion won (USD 45.9 million) or less;
2. Applicant must be a manufacturer, wholesaler, retailer, or service provider (the NTS plans to expand to other business types in the future);
3. Only unilateral APAs are allowed;
4. APAs will be approved within one year from the submission of an application; and
5. Reduced scope of supporting documentation for the APA package will be required. During the prefiling meeting, the applicant and the APA team will discuss specifically what information is to be provided, simplified, or exempted. The documents that may be

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reduced or exempted relate to transfer pricing analysis, such as comparability analysis, benchmarking analysis, description of methodology applied to the segmentation of financial statements, and critical assumptions. Please refer to appendix below for the table of APA documentation.

Other administrative support available for inbound taxpayers

In addition to the simplified APA program, the press release revealed the following assistance will become available for inbound and other taxpayers:

- The tax authorities will provide a Tax Audit Guidebook in English for inbound taxpayers, with all procedural details regarding tax audits, remedial procedures, and other topics that may be of interest (such as MAP and APA procedures). The English guidebook is now downloadable from http://www.nts.go.kr/eng.
- Taxpayers will be able to hold face-to-face counseling (or advisory) sessions with the head of the audit division (at taxpayers' request) to discuss and resolve various difficulties that may arise during a tax audit, as well as any controversy that may rise from different viewpoints, such as the selection of a transfer pricing method.
- The tax authorities aim to improve communications with inbound taxpayers by receiving feedback on tax administration issues and resolving them on a timely basis. The NTS plans to utilize various channels, including holding meetings with representatives of inbound business associations on a quarterly basis to listen to tax administration issues, conducting taxpayer satisfaction surveys in cooperation with the Korea Trade Investment Promotion Agency (KOTRA), and assigning tax officials to provide e-mail assistance regarding various issues and questions.
- The NTS will provide monthly English alerts regarding updated tax news, including interpretation of tax laws, recent cases, etc., in cooperation with KOTRA and foreign chambers of commerce in Korea.

Concluding remarks

The NTS's new initiatives aim to increase transparency regarding tax administration and to improve communication with inbound taxpayers. In so doing, the NTS will focus on easing the burden of tax audits by listening to diverse voices of inbound taxpayers, reducing unnecessary misunderstandings on various tax administration issues, and providing a business-friendly tax environment.

At least for the initial period, the simplified APA program is likely to be tested. At the end of the day, the single most important issue for both taxpayers and the NTS will be the level of profit they can agree on. As a number of the key components in comparability analysis are either simplified or exempted, how and what level of profit will be offered and negotiated on the table remains to be seen. Maybe, more importantly, global headquarters will have to manage a local level of profit that could be concludable under the simplified APA program in terms of global consistency in the context of BEPS. That's why some taxpayers are rather cautious, adopting a "wait and see" attitude, as BEPS action plans are still unfolding.

Inbound taxpayers have welcomed this move. The overall mood is positive, and initiatives such as providing English tax news updates on a monthly basis and assigning tax officials

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exclusively to respond to various taxpayer inquiries in English via email are new and welcome. No doubt the initiatives will greatly help improve communications between local managers at inbound companies in Korea and headquarters.

Appendix: Table of Required Documents for Standard and Simplified APA Applications

<table>
<tr><th colspan="2">Required information/form (stipulated under the Article 9 of Presidential Decree (PD) of Law for the Coordination of Tax Affairs (LCITA)</th><th>Standard APA</th><th>Simplified APA</th></tr>
<tr><td>1</td><td>APA Application Form (Form 3 stipulated in Article (3) Section (1) of the Ministerial Enforcement Decree of LCITA) describing the covered year, covered controlled transaction, covered parties, and transfer pricing method</td><td>Yes</td><td>Yes</td></tr>
<tr><td>2</td><td>Overview of the business: history, business profile, organization, and shareholder information</td><td>Yes</td><td>Yes</td></tr>
<tr><td>3</td><td>Financial statements for the past three years, a copy of tax returns, a copy of contracts for the international transactions, and other relevant documents</td><td>Yes</td><td>Yes</td></tr>
<tr><td>4</td><td>Documents describing the suggested transfer pricing methodology as listed below in 4-a to 4-e.</td><td>Yes</td><td rowspan="6">Simplified or exempted</td></tr>
<tr><td>4-a</td><td>Methods used to evaluate comparability and the appropriate adjustments made as provided in Article 5 (2) and Article 6 (2) of LCITA-PD</td><td>Yes</td></tr>
<tr><td>4-b</td><td>Description of the difference in accounting principles and adjustments made to comparable companies</td><td>Yes</td></tr>
<tr><td>4-c</td><td>Description of the segmentation standards, if segmented financials or cost data are used</td><td>Yes</td></tr>
<tr><td>4-d</td><td>The arm’s length range and the method for its calculation, if two or more comparable companies are used</td><td>Yes</td></tr>
<tr><td>4-e</td><td>Information describing the conditions or assumptions for the TPM</td><td>Yes</td></tr>
<tr><td>5</td><td>Methods used to adjust the differences between the actual transaction price and the arm’s length price as provided in Article 7 (2) of LCITA-PD</td><td>Yes</td><td>Yes</td></tr>
<tr><td>6</td><td>The MAP application form designated by the Ministry of Strategy and Finance, if the taxpayer requests a MAP</td><td>Yes, in the case of a bilateral APA</td><td>No</td></tr>
<tr><td>7</td><td>Other data supporting the appropriateness of the TPM for the APA</td><td>Yes</td><td>Yes</td></tr>
</table>

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