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Global Transfer Pricing

Arm's Length Standard

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In this issue:

OECD Issues Guidance on CbC Reporting Implementation 1
India, United States Reach Agreement to Solve Backlog of Competent Authority Cases 2
Singapore Releases New Transfer Pricing Guidelines 3
Ukraine Introduces Changes to Transfer Pricing Legislation 10
Australia Releases Final Guidance on Transfer Pricing Documentation, Simplified Record-Keeping Options 13
New Spanish Transfer Pricing Rules Enter Into Effect; Government Announces Adoption of Country-by-Country Reporting 15
France Increases Penalties for Failure to Comply With Transfer Priicng Documentation Rules 18
Iceland Introduces New Transfer Pricing Regulation 19
Chile´s Tax Reform and its Effects on Transfer Pricing Legislation 20
Finland Considers Changes to Transfer Pricing Adjustment Rules 21
US MTC Executive Committee to Formally Solicit State Commitments for Transfer Pricing Initiative 22

OECD Issues Guidance on CbC Reporting Implementation

The Organization for Economic Cooperation and Development on February 6 released guidance on the implementation of transfer pricing documentation and country-by-country (CbC) reporting. The eagerly awaited guidance provided answers to taxpayers' questions regarding the timing of preparation and filing of the CbC report, which companies will be subject to the reporting requirements, the use of the CbC report by jurisdictions, and the mechanisms for government-to-government exchange of CbC reports.

The guidance requires CbC reporting by multinational enterprises (MNEs) with annual consolidated group revenues above EUR 750 million. According to the OECD, this threshold will exclude approximately 85 to 90 percent of all MNE groups from the requirement to file the CbC report, but would still subject MNE groups that control approximately 90 percent of all corporate revenue to the requirement.

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The OECD states that the EUR 750 million reporting threshold should strike the right balance between the imposition of a reporting burden and benefits to tax administrations. Moreover, the appropriateness of the threshold will be subject to review as part of the 2020 review of implementation of the new reporting standard.

The first CbC reports will be required to be filed for MNE fiscal years beginning on or after January 1, 2016. Given the recommendation in the September 2014 report "Guidance on Transfer Pricing Documentation and Country-by-Country Reporting" that MNEs be allowed one year from the close of the fiscal year to which the CbC report relates to prepare and file the CbC report, the first CbC reports would be filed by 31 December 2017. For MNEs with fiscal years that end on a date other than December 31, the first CbC report would be filed later in 2018, 12 months after the close of the relevant MNE fiscal year, and would report on the MNE group's first fiscal year beginning after January 1, 2016.

It should be noted that the MNE fiscal year relates to consolidated reporting period for financial statement purposes, not to taxable years or the financial reporting periods of individual group entities.

The countries participating in the BEPS project have agreed that they will have in place and be prepared to enforce legal protections of the confidentiality of the information in the CbC report equivalent to those under the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, a tax information exchange agreement (TIEA) or a tax treaty.

In terms of the appropriate use of the information in the CbC report, the guidance states that jurisdictions will commit to use the CbC report for assessing high-level transfer pricing and other BEPS risks, but should not propose adjustments to income on the basis of an income allocation formula based on CbC report data. However, jurisdictions would not be prevented from using the CbC report information as the basis for making additional inquiries into the MNE's transfer pricing arrangements, which arguably is the goal of the OCED's current CbC initiative.

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India, United States Reach Agreement to Solve Backlog of Competent Authority Cases

In separate statements to the media, India's Competent Authority Akhilesh Ranjan and US Competent Authority Douglas O'Donnell confirmed that the two tax authorities have reached broad agreement on a framework for resolving many pending US-India Mutual Agreement Procedure cases to resolve double taxation arising from India-initiated transfer pricing adjustments.

The agreement follows meetings in India on January 15 and 16 attended by O'Donnell, Hareesh Dhawale (acting IRS APMA director), and John Hughes (IRS APMA senior manager

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responsible for India cases). While the details of the framework are still being finalized, discussions we have had with the tax authorities indicate the following:

- The settlement framework relates to IT Enabled Services (ITES) and software development services. These cases represent the majority of the MAP inventory between the two countries. The framework includes the commitment to resolve both the appropriate cost plus markup as well as the related cost base on which the markup is applied. Each case will be settled separately based on its unique facts. The number of tax years to be covered by the settlement framework has not been finalized.
- The IRS APMA team will soon contact companies included in the settlement framework to request additional information and to discuss the proposed settlement.
- The two competent authorities plan to schedule a formal MAP meeting this year, but the date has not been scheduled. In the meantime, the two tax authorities plan to communicate via phone and email to resolve cases.
- The IRS has not formally agreed to accept bilateral APAs at this time. However, the IRS understands that taxpayers have a March 31 APA filing deadline in India and it has stated that it will accept bilateral APA requests once the cases included in the settlement framework have been resolved. The IRS will also consider accepting APA requests from taxpayers that want to convert their unilateral India APA requests into bilateral requests.

Samir Gandhi, Deloitte India's Transfer Pricing leader, said "This is a timely development on the eve of President Obama's visit to India. It's a welcome step, given that the United States is India's biggest trading partner and investor. Transfer pricing disputes are complex, and resolving disputes through the MAP and APAs is most efficient, because the normal appeals process in India is time consuming and uncertain."

We will learn more about the settlement framework as the two tax authorities begin resolving the affected cases.

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Singapore Releases New Transfer Pricing Guidelines

The Inland Revenue Authority of Singapore (IRAS) on 6 January 2015 released revised transfer pricing guidelines. The new, comprehensive guidelines replace the transfer pricing guidelines issued in 2006, and three supplementary guidelines/circulars issued in 2008 and 2009.

Key Changes

The most significant change in the revised guidelines is the new requirement and expectation that taxpayers prepare and maintain transfer pricing documentation to substantiate that their

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related-party dealings are at arm's length. The concept of contemporaneous documentation has been defined in the new guidelines.

Aside from the documentation requirement, the new guidelines also contain various updates to key transfer pricing principles and approaches, discussed below.

Transfer Pricing Documentation Requirement: The new guidelines are explicit in requiring taxpayers to "prepare and keep contemporaneous records," and this is to be "part of the record-keeping requirements for tax".

What constitutes contemporaneous documentation?

The new guidelines provide specific details on the contemporaneous documentation requirement.

IRAS requires taxpayers to prepare transfer pricing documentation on a timely basis, which is defined as "no later than the tax return filing date for the financial year in which the transaction takes place. The guidelines require that the date of creation or update of each document must be stated in the document."

The new guidelines also state that "in preparing contemporaneous documentation, a taxpayer may use the latest available information" at the time of preparation. If the taxpayer is subject to an audit by the IRAS or is required to submit documentation subsequently, the information used at the time of preparation will be accepted.

The new guidelines include an expanded list of required information, particularly pertaining to information at the group level, which will require more time and effort by the taxpayers to document. However, the guidelines do not require or advocate that documentation be prepared in a master file/ local file format, and there is no country-by-country reporting requirement.

Group-Level Documentation: The new guidelines require substantially more group-level details, which should provide "a good overview of the group's businesses." Specifically, under the new guidelines, the following types of information to be included as group-level documentation are listed:

- A worldwide organizational structure chart, showing the location and ownership linkages among all related parties;
- Description of the group's business, including:
    - The group's lines of business, products and services, geographic markets, and key competitors;
    - The industry dynamics, market, regulatory and economic conditions in which the group operates;
    - The group's business models and strategies, including any recent restructuring, acquisition, or divestiture;
    - Important drivers of business profits and a list of intangibles and the related parties that legally own them;

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- The principal business activities and functions of each group entity, including charts showing the supply chains of products and services; and
- The business relationships (services provided, goods sold, development, ownership or exploitation of intangibles, financing arrangements, etc.) among all related parties.

- The group's financial information
  - Financial statements of the group relating to the lines of business involving the Singapore taxpayer.

The expanded list of information required at the group level will require more time and effort from the taxpayer.

Entity Level Documentation: The new guidelines require entity-level documentation that provide sufficient details of the taxpayer's business and its transactions with related parties.

Most of the items required as entity-level documentation are already covered under Singapore's former transfer pricing guidelines, and most transfer pricing documentation prepared by Singapore taxpayers would include these details, with the exception of the following items:

- A description of the Singapore taxpayer's management structure, including a description of the individuals to whom the Singapore management reports and the countries in which those individuals maintain their principal offices; and
- An organizational chart of the Singapore taxpayer, showing the number of employees in each department.

While this information should be available to the Singapore taxpayer, it is normally not prepared or organized from a transfer pricing perspective. Care must be taken to review the information and, if necessary, reorganize it in a way that is consistent with the functional analysis of the Singapore taxpayer, and document this in the documentation.

Safe-harbor threshold for Documentation Preparation: The new guidelines provide exemption from the documentation requirement in the following situations:

- When the taxpayer transacts with a related party in Singapore and the local transactions (excluding related-party loans) are subject to the same Singapore tax rates for both parties;
- When a related domestic loan is provided between the taxpayer and a related party in Singapore, and the lender is not in the business of borrowing and lending;
- When the taxpayer applies the 5 percent cost mark-up for services that qualify as "routine" services, as defined in the guidelines;
- When the related-party transactions are covered by an agreement under an advance pricing agreement; and
- When the value or amount of the related-party transactions does not exceed the thresholds below:

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Category	Threshold (S$) per financial year
Purchase of goods from all related parties	15 million
Sale of goods to all related parties	15 million
Loans owed to all related parties	15 million
Loans owed by all related parties	15 million
All other categories of related-party transactions, including: • Service income • Service payment • Royalty income • Royalty expense • Rental income • Rental expense	1 million per category of transactions

The introduction of the above safe-harbor thresholds for preparing transfer pricing documentation should serve to limit taxpayers' compliance and administrative costs, in relation to low-risk transactions.

Maintenance and Update of Documentation: The new guidelines now require contemporaneous transfer pricing documentation to be prepared no later than the tax return filing date of the financial year in question. However, taxpayers are not required to submit their transfer pricing documentation when the tax returns are filed. The documentation should be kept by taxpayers and submitted to IRAS within 30 days when requested to do so. No extension of this 30-day period is mentioned in the new guidelines, and it is unclear whether extensions would be granted on a case-by-case basis.

The new guidelines also recommend that transfer pricing documentation be reviewed periodically to ensure that the functional and economic analyses are still accurate and valid.

Specifically, the guidelines state that taxpayers should update their transfer pricing documentation when there are "material changes"; in the absence any such major change, documentation should be updated "at least once every three years."

Consequence of Not Preparing Contemporaneous Documentation: Failure to prepare and maintain contemporaneous documentation has the following adverse consequences:

- The lack of documentation increases the chances of transfer pricing adjustments under Section 34D of the Singapore Income Tax Act (ITA) during an audit conducted by the IRAS. The new guidelines formally incorporate (at section 7 of the guidelines) the Transfer Pricing Consultation (TPC) program, which provides guidance on the process the IRAS undertakes to audit and review taxpayers' related-party transactions, and remind taxpayers at paragraph 7.10 that during an audit or review, "IRAS may propose a tax adjustment under Section 34D of the ITA if the taxpayer's taxable profit is understated due to non-arm's length related-party transactions." IRAS has conducted the TPC program since 2008, and the availability of transfer pricing documentation has proven effective in mitigating the risk of adjustments, or in some cases, reducing the final amount of adjustments.

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- The acceptability of year-end adjustments is now conditioned on contemporaneous documentation being prepared at the time of making the adjustments. Without preparing such documentation, any year-end adjustments made (resulting in reduced income) would not be accepted for Singapore tax and transfer pricing purposes. This will be discussed in greater details in the next section.
- Consistent with the existing guidelines, IRAS may not support a taxpayer's mutual agreement procedure (MAP) application in the event of transfer pricing adjustments made by foreign tax authorities. However, the new guidelines highlight the possibility that IRAS also may decline APA requests made by the taxpayer.
- If taxpayers fail to timely submit adequate documentation upon request by IRAS, they may be penalized under Section 94(2) of the SITA for not complying with the record-keeping requirements under Sections 65, 65A, and 65B of the SITA. The penalty under Section 94(2) involves a fine not exceeding S$1,000 or a jail term not exceeding six months in lieu of payment.

In keeping with the existing guidelines, the new guidelines do not impose a specific transfer pricing penalty for lack of sufficient or timely documentation, opting instead to rely on the general penalties and record-keeping provisions in the ITA stated above. However, a clear message of intent is found at footnote 7 of page 30, where it states that "IRAS is monitoring the compliance level and may, if necessary, consider more stringent measures including specific record-keeping regulations for transfer pricing."

Other significant changes

The new guidelines also contain a number of technical updates and changes, discussed below.

Selection of Comparables: The new guidelines provide three notable points on the selection of comparables. First, the new guidelines indicate a preference for listed companies over unlisted companies as comparables, on the basis and belief that there is more publicly available information regarding the former than the latter.

Second, the guidelines state an explicit preference for local companies as comparables. A taxpayer may use suitable regional comparables, but only if an attempt has been made to identify local comparables and an insufficient number of such comparables is available.

Lastly, the guidelines provide guidance on the admission and rejection of loss-making comparables. Generally, a comparable with weighted average loss for the tested period or that has incurred a loss for more than half of the tested period is considered unreliable as a benchmark.

Choice of Profit Level Indicators (PLIs): The new guidelines set out the commonly used PLIs in applying the transactional net margin method (TNMM), which are largely consistent with the OECD's transfer pricing guidelines.

The discussion on the Berry ratio is new and notable. The guidelines refer to the Berry ratio as an "alternative" indicator and should be use when all of the following conditions are met:

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- The taxpayer acts as an intermediary purchasing goods from related parties and on-selling them to other related parties;
- The taxpayer does not perform any value-added functions other than distribution relating to the products distributed;
- The value of the functions performed by the taxpayer is not affected by the value of products distributed;
- There is a direct link between operating expenses and gross profits; and
- The taxpayer does not employ any intangibles in the particular transaction.

The overall tone of the discussion hints at the IRAS's requiring a high threshold for the use of the Berry ratio, and this is consistent with experience dealing with the IRAS during the TPC process. The guidelines view the Berry ratio as sensitive to cost classification, and hence "[u]sing it without caution can result in comparability issue." Therefore, the Berry ratio "should only be used in limited cases."

Therefore, companies that currently adopt the Berry ratio as part of their transfer pricing policy or as a method of testing arm's length results should evaluate the continued use of the ratio based on IRAS's guidance and views.

Use of Arm's Length Range and Testing of Results: The new guidelines affirm the use of the interquartile range as a reliable approach to ascertain the arm's length range. They mention that the full range "may occasionally" be used to ascertain the arm's length price, but only if it can be ascertained that all points of the range are equally reliable.

In terms of testing of financial results, the guidelines explicitly mention testing of annual results of the tested party as the appropriate approach, and that multiyear testing may be accepted only under exceptional circumstances.

Year-End Adjustments: The guidelines require taxpayers to test the financial results of the tested party annually, and to make appropriate year-end adjustments at the year-end closing of financial statements. Such year-end adjustments will be recognized for Singapore tax and transfer pricing purposes if the following conditions are met:

- Taxpayers must have in place transfer pricing analyses and contemporaneous transfer pricing documentation as defined in the new guidelines;
- Taxpayers should make the year-end adjustments symmetrically in the accounts of the affected related parties; and
- Taxpayers must make the adjustments before filing their tax returns.

Retrospective adjustments are generally not allowed as a tax deduction, although the guidelines do not preclude the possibility of bring such adjustments (if resulting in additional Singapore income) to tax.

Related-Party Loans: The new guidelines incorporate the existing guidance provided on related-party loans, and one notable addition is the discussion on the issue of credit worthiness. The new guidelines state that IRAS's preference is to evaluate credit worthiness on a stand-alone basis (i.e., of the borrower), but leaves the possibility of using the group's

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credit standing, if “it can be substantiated that an independent lender will similarly accept such group credit rating.”

Conclusion

Transfer pricing will continue to be a focal point for IRAS. The new guidelines represent a significant milestone in Singapore’s transfer pricing regime, and are continuing affirmation of IRAS’s intent to ensure that taxpayers maintain sufficient transfer pricing documentation and comply with the arm’s length principle.

With the release of the new guidelines, taxpayers should:

- Prepare and maintain contemporaneous documentation as required under the new guidelines. Doing so will ensure that the risk of transfer pricing controversy and disputes with IRAS are mitigated. Even in the absence of an IRAS audit, the acceptability of year-end adjustments is now conditioned on contemporaneous documentation being prepared at the time of making the adjustments. Without preparing such documentation, any year-end adjustments made (resulting in reduced income) would not be accepted for Singapore tax and transfer pricing purposes.
- For taxpayers who have prepared transfer pricing documentation, it will now be timely to consider updating the documentation, in view of the new informational requirements (for example, group information), and the guidelines’ requirement to update documentation at least once every three years.
- In terms of timing of preparing documentation, since testing must be done on an annual basis and year-end adjustments are made during the closing of the financial statements, contemporaneous documentation should be prepared before the financial year-end, even though taxpayers may have until the time of filing the tax return to prepare contemporaneous documentation.
- When the new guidance on various aspects of transfer pricing analysis (such as the use of the Berry ratio, preference for local comparables, and the acceptable use of loss-makers) is relevant, it would be advisable to reevaluate the relevant transactions or supporting analyses, and assess what additional support is required to comply with the new guidance/positions.
- The general acceptance of assessing credit-worthiness on both a stand-alone and group basis removes uncertainty on the IRAS’s position on this issue. Taxpayers with related-party loans should reassess which approach would be most appropriate in their circumstances, and adjust their transfer pricing analysis or policies on such interest rate pricing accordingly (if necessary).

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Ukraine Introduces Changes to Transfer Pricing Legislation

Ukraine's Parliament on 28 December 2014 approved a law that significantly amends the transfer pricing rules in Ukraine. These changes generally bring the Ukrainian transfer pricing legislation closer to the OECD transfer pricing guidelines. However, many of the changes may be seen as more restrictive in nature for taxpayers.

Key provisions

The new law entered into force on 1 January 2015. Accordingly, the new rules apply to transactions entered into on 1 January 2015 and thereafter.

The law does not apply to transactions between Ukrainian residents; it applies only to cross-border transactions. Thus, domestic transactions are no longer covered by the transfer pricing regulations.

Likewise, the new transfer pricing rules are not supposed to apply to the value-added tax, only to corporate income tax. However, the wording in the new law in respect of application of value-added is ambiguous, which may give room for different interpretations on the part of the taxpayers and the tax authorities.

Controlled transactions with nonresidents

The list of foreign controlled transactions subject to the Ukrainian transfer pricing regime has grown. Effective 1 January 2015, the transfer pricing rules apply to the following transactions with nonresidents:

- Related-party transactions (in line with the old rules);
- Business transactions involving the sale of goods through nonresident commission agents (a new rule);
- Transactions with nonresidents registered in low-tax jurisdictions. Under the new rules, the list of these jurisdictions will be published by the Cabinet of Ministers of Ukraine (the CMU) and will serve as the definitive source of what are deemed to be low-tax jurisdictions. This rule deviates from the previous regulations, under which any transaction with a nonresident could potentially be deemed controlled if the nonresident (regardless of residency) turned out to be paying tax at a low rate;
- Transactions between related parties that involve independent intermediaries with no substantial functions (a new provision). This provision is aimed at preventing evasion of the transfer pricing rules by involving third parties in controlled transactions.

New threshold for controlled transactions

Groups of transactions with the same counterparty will be treated as controlled transactions, provided the following two conditions are met:

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- The volume of the transactions exceeds the lesser of UAH 1 million or 3 percent of taxable income;
- The revenue of the taxpayer and/or its related parties exceeds UAH 20 million for the tax year.

The proposed new provisions will increase the number of controlled transactions (given that the previous threshold was set at UAH 50 million). They also are ambiguous and allow for various interpretations.

New rules for submission of transfer pricing reports

The law provides for three types of transfer pricing reports:

- Transfer pricing documentation. The term for submission has been reduced to one month (the previous version of the rules allowed up to two months for the provision of transfer pricing documentation by large taxpayers).
- An annex to the corporate income tax return with information on controlled transactions performed (no such provision existed in the earlier version of the rules); and
- Report on controlled transactions if the volume of controlled transactions with the same counterparty exceeds UAH 5 million in a tax period (the previous version required submission of the report on all controlled transactions).

Priority of sources of information has been repealed

In an important change, the priority of official sources of information has been repealed. Under the new rules, preference should be given to any publicly available sources that provide the most reliable and relevant information required for determining comparability of commercial and financial conditions.

The new rules clearly allow the use of comparable transactions performed by the taxpayer's counterparty in the controlled transaction (this provision was not clearly specified in the previous regulations).

Amendments to Transitional Provisions

Special transfer pricing rules included in Article 21 of the Transitional Provisions (which apply to the export/import of some product groups to/from certain jurisdictions) have been amended. They now openly require the use of the comparable uncontrolled price method, with the focus being on the comparison of prices with those on recognized exchanges.

Taxpayers are allowed to use other (margin-based) methods. However, to use those methods taxpayers are required to disclose information on all related parties in the supply chain, and the profit margins earned by those related parties.

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Adjustment of tax liabilities

In case of any deviation from the arm's length price range, tax liabilities should be adjusted to the median of the arm's length range. This relates to both self-initiated adjustments and adjustments made by the tax authorities.

The previous version of the law required adjustment in accordance with the minimum/maximum points on the range, which was more advantageous to taxpayers.

Significant increase in penalties

The new law establishes the following fines for failure to submit the controlled transactions report and transfer pricing documentation:

- 100 minimum wages (approx. UAH 121,000) for nonsubmission of the controlled transactions report (the same as in the previous version of the law);
- 5 percent of the amount of transactions not included in the controlled transactions report (new provision);
- 3 percent of the amount of transactions, but no more than 200 minimum wages (approx. UAH 244,000) for all undeclared transactions, for failure to submit transfer pricing documentation (the previous version provided for a fine equal to 10 minimum wages).

There is a risk that the new fines will apply to transfer pricing violations regarding transactions performed before the law took effect (that is, in 2013 and 2014).

Changes to determination of related parties

The list of cases when companies are treated as related parties has been extended. Now, if a company grants a loan or repayable financial aid (an interest-free loan), and the outstanding amount of that loan/repayable financial aid exceeds 3.5 times the equity capital of the recipient legal entity, the two entities are treated as related parties.

Additionally, the new rules provide that all members in a "vertical ownership chain," where each shareholding exceeds 20 percent, should be treated as related parties.

Mitigation of restrictions on deductibility of royalties and other expenses

Under the new law, some expenses with limited deductibility under the general rules (such as royalty payments) now may be deducted in full, provided the transfer pricing documentation confirms that the expenses are at arm's length.

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Australia Releases Final Guidance on Transfer Pricing Documentation, Simplified Record-Keeping Options

The Australian Taxation Office recently released an important package of guidance dealing with transfer documentation that includes:

- Taxation Ruling TR 2014/8 – Income tax: transfer pricing documentation;
- Practice Statement Law Administration PS LA 2014/2 – Administration of transfer pricing penalties; and
- Practice Statement Law Administration PS LA 2014/3 – Simplifying transfer pricing record keeping

The release of ATO guidance was highly anticipated, given the uncertainty taxpayers face regarding their obligations under Australia's new transfer pricing rules.

TR 2014/8

TR 2014/8 replaces Draft Taxation Ruling TR 2014/D4 and Draft Practice Statement Law Administration 3673.

TR 2014/8 sets out the Commissioner of Taxation's views on the transfer pricing documentation an entity should keep to meet the requirements of Subdivision 284-E of Schedule 1 to the Taxation Administration Act 1953. If those requirements are not met, any penalties subsequently imposed will apply as though the transfer pricing treatment was not reasonably arguable. Meeting the documentation requirements will mean that a taxpayer is able to argue that its transfer pricing treatment was reasonably arguable, notwithstanding that the position is ultimately found to be incorrect.

In Draft PS LA 3673, the ATO had set out a five-step process for documenting transfer pricing. This process has been replaced in TR 2014/8 with five "key questions" for an entity to consider when documenting its transfer pricing treatment:

- What are the actual conditions that are relevant to the matter (or matters)?
- What are the comparable circumstances relevant to identifying the arm's length conditions?
- What are the particulars of the methods used to identify the arm's length conditions?
- What are the arm's length conditions and is/was the transfer pricing treatment appropriate?
- Have any material changes and updates been identified and documented?

TR 2014/8 also contains specific guidance on how the ATO believes taxpayers should address the transfer pricing reconstruction provisions in section 815-130 of the Income Tax Assessment Act 1997.

PS LA 2014/2

PS LA 2014/2 replaces Draft Practice Statement Law Administration 3672. It explains:

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- When an entity will be liable for a transfer pricing penalty;
- How the entity's transfer pricing penalty is assessed; and
- How the Commissioner's discretion in relation to remission should be exercised.

PS LA 2014/3

PS LA 2014/3 provides guidance for ATO personnel on applying options under the ATO's online guidance Simplifying Transfer Pricing Record Keeping.

The simplification options are aimed at easing the administrative burden of complying with the transfer pricing documentation rules, and apply for three consecutive income years, the first of which commences on or after 29 June 2013.

The simplification options broadly apply to certain categories of taxpayers and transactions, including:

- Small business taxpayers;
- Distributors;
- Intragroup services; and
- Low-level inbound loans.

The applicability of the options must be demonstrated by meeting specific eligibility criteria. However, an entity is ineligible to apply any of the options when it has:

- Incurred losses for three consecutive years;
- Entered into related-party dealings with entities in specified countries; or
- Undergone a restructure within the year.

When an entity meets the specific criteria for each simplification option, it can elect to apply the relevant option(s) and ATO officers will then be precluded from reviewing records that relate to the relevant cross-border condition between entities for purposes of the transfer pricing rules.

While the simplification options are a welcome relief for those that qualify, the general exclusion criteria and eligibility requirements are such that very few companies are likely to apply the options in practice. For the vast majority of companies, documentation that meets all the requirements of Subdivision 284-E for documenting the application or non-application of the transfer pricing rules to a matter will still be necessary.

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New Spanish Transfer Pricing Rules Enter Into Effect; Government Announces Adoption of Country-by-Country Reporting

The broad-based tax reform the Spanish government originally proposed in June 2014, which was published in the official gazette on November 28, 2014, became effective on January 1, 2015. The tax reform introduced a new Corporate Income Tax Law, as well as extensive changes to Spain's transfer pricing regime.

In related news, the government announced January 20 that it will include the Organization for Economic Cooperation and Development's proposed country-by-country reporting template in the corporate income tax regulations to be issued under the new income tax law.

The major changes regarding the transfer pricing regime are summarized below.

Definition of Related Party

The new transfer pricing legislation establishes new exceptions to the definition of related parties, including the following:

- An entity and the members or investors of another entity when both entities belong to the same group.
- Remuneration paid by an entity to its directors (both official directors and those acting as such) for their activities as such does not establish a related-party relationship.
- Nonresident entities and their permanent establishments in Spain (however, it is important to note that this scenario has been included in the nonresidents' income tax law).
- Entities belonging to a group taxed under the regime for groups of cooperative companies.

The ownership percentage threshold for parties to be deemed related has been raised to 25 percent from the previous 5 percent (or 1 percent in the case of listed shares on a regulated market).

Documentation Requirements

A general reference to proportionality and sufficiency principles in relation to the obligation to make transfer pricing documentation available has been introduced.

The option to prepare simplified documentation has been broadened to include related persons or entities with turnover below €45 million (the previous limit was €10 million). This regime cannot be applied to:

1. Transactions entered into with related entities by personal income taxpayers in the course of economic activity;
2. Share transfers;
3. Business transfers;
4. Real estate transactions; and
5. Transactions involving intangible assets.

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The documentation exceptions previously found in the regulations – for example, those for transactions within a consolidated tax group, and transactions between two related entities that involve amounts not higher than €250.000 – have been included in the new law.

Transfer Pricing Methods

The five transfer pricing methods continue to be used to support the arm's length nature of prices in controlled transactions. Nevertheless, the primacy of the comparable uncontrolled price (CUP) method, the cost plus method, and the resale price method vis-à-vis the transactional net margin method and the transactional profit split method has been eliminated. To select the most appropriate method, as the OECD transfer pricing guidelines prescribe, factors such as the nature of the transactions, the availability of reliable information, and the degree of comparability must be taken into account.

Other pricing methods are now allowed, as long as they are consistent with the arm's length principle.

Related-party transaction categories

Regarding intragroup services and cost sharing agreements, to be deductible, it is required that they produce a benefit or be useful to the recipient of the transaction.

In the case of services provided by professional individuals to a related entity, the agreed price is required to be at arm's length. This is a safe harbor rule for valuing transactions between professional services firms and their partners/shareholders.

The new limitation set out in article 15(j) of the law, which establishes that expenses associated with transactions performed with related persons or entities that, as a consequence of a different tax characterization, do not generate income or generate exempt income or income subject to a nominal rate below 10 percent, are not deductible.

Advance Pricing Arrangements

Unlike in the previous tax law, advance pricing agreements now may extend not only to transactions existing in the period in which they agreements were concluded, but also to previous years, in so far they are not statute-barred and the authorities have not issued a final assessment in relation to the transactions carried out on those years and included in the request.

Permanent Establishments

A new section has been introduced regarding taxpayers with permanent establishments abroad (internal dealings). If allowed by an applicable tax treaty, a taxpayer's tax base may include its foreign permanent establishment's estimated income (on an arm's length basis) derived from domestic transactions with the latter.

In line with the above, the nonresident income tax law also allows (insofar as it is permitted by a tax treaty), to determine the revenue of a permanent establishment located in Spain, to

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deduct estimated expenses regarding domestic transactions performed with both their head office and any of their permanent establishments located outside Spain.

Secondary Adjustment

As a consequence of the Spanish Supreme Court's decision of May 27, 2014, the treatment of valuation differences within members or investors-entity related transaction, has been incorporated into the new law.

The tax effects of the so-called secondary adjustments can be avoided if at the time of the tax audit, the taxpayer agrees to amend the incorrect pricing to comply with the arm's length standard.

The arm's length value reviewing procedure

The option, previously found in the law, to use an appraisal by an expert to challenge the tax authorities' conclusion regarding the arm's length value of a particular transaction has been eliminated.

Tax authorities are allowed not only to review the value, but also the legal characterization of transactions carried out by related parties. This is clearly a result of the BEPS Action Plan on the new transfer pricing legislation.

Penalty Regime

Spain's penalty regime has become less burdensome in the new legislation.

- Failure to provide documentation, or the delivery of incomplete or false information will be subject to a penalty of €1,000 for each item of false or omitted data, and €10,000 euros for each set of omitted or false data. Additionally, the reference to "inaccurate data" has been removed.
- When the arm's length value differs from the prices reported by the taxpayer in the corporate income tax return, the penalty will equal 15 penalty of the value adjusted by the tax authorities.
- The determination of the arm's length value of transactions for corporate income tax, nonresident income tax, and personal income tax purposes has no effect on the determination of arm's length value of those transactions for purposes of other taxes (in other words, one does not bind the other).

Country-by-Country reporting obligations

The Spanish government recently announced that the future corporate income tax regulations will include a country-by-country reporting obligation. This measure is aligned with Action 13 of the OECD's BEPS Action Plan, which calls for the development of rules to enhance transparency for tax authorities. No official report or form has been disclosed yet, but it is expected to be a comprehensive report that will include the activity and taxes paid in every country where the Spanish-headquartered multinational groups operate. It is expected that companies exceeding a certain turnover will have to file the report with their tax return. The

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new corporate income tax regulations are not yet in force, but they are expected to be adopted in the first half of 2015. Information will be delivered most likely when the corporate income tax return for 2016 is due to be filed.

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France Increases Penalties for Failure to Comply With Transfer Priicng Documentation Rules

France's 2015 Finance Bill, enacted December 29, 2014, increased the penalties applicable in cases of failure to comply with the French transfer pricing documentation rules.

According to newly drafted Article 1735 ter of the French Tax Code, companies that fail to provide sufficiently detailed documentation regarding their intragroup transactions following an official request by the French tax authorities will be subject to penalties equal to the higher of two amounts:

- 0.5 percent of the amount of the transactions for which insufficient documentation has been presented; or
- 5 percent of the transfer pricing reassessments related to those transactions.

The penalty amount cannot be less than €10,000 for each fiscal year under audit.

There is no clear provision in the law describing precisely what constitutes a lack of compliance; thus, this might be subject to discussion with the French Tax Administration.

The new rule is applicable to any tax audit started after January 1, 2015.

In the previous version of Article 1735 ter, the penalty was not related to the amount of the transaction under review. In essence, this introduces significant penalties for lack of or insufficiency of documentary compliance, even if transfer prices are contracted at arm's length.

This new statement demonstrates a much stricter attitude by the French tax authorities regarding the level of documentation that French entities should prepare and present in case of a tax audit. We believe that specific instructions will be provided to tax inspectors to challenge more vigorously the level of compliance with transfer pricing documentation requirements in line with the stipulations of Article L13AA of the French Tax Procedure Code, and thus, to apply these penalties on a more regular basis.

This article has been prepared by professionals in Taj, French tax and legal firm, member of Deloitte Touche Tohmatsu Limited.

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Iceland Introduces New Transfer Pricing Regulation

Iceland's Ministry of Finance and Economic Affairs on December 16, 2014, issued a final regulation on transfer pricing documentation and transactions between related entities, which entered into effect on January 1, 2015.

The regulation is based on Article 57 of the Income Tax Act no. 90/2003, which was amended by Law No. 142/2013 to adopt into Iceland's Income Tax Act the Organization for Economic Cooperation and Development's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. The OECD transfer pricing guidelines were adopted as of January 1, 2014.

The regulation and the law impose additional transfer pricing documentation requirements. Under the regulation, transfer pricing documentation must include the information listed below. Special consideration should be given to requirements concerning intangible assets, immaterial transactions, and the submission of information in tax returns in line with the OECD's BEPS initiative regarding country-by-country reporting.

Article 8 of the regulation states that any intangible assets within the group that have an effect on documented transactions must be described in the documentation. The description must contain information on the ownership, use, development, and maintenance of the intangible assets. In addition, information must be provided on the probable resale price and net present value of expected future earnings from the intangible assets.

Article 12 of the regulation states that the exemption for immaterial transactions between related entities does not apply to transactions involving intangible assets.

Article 13 of the regulation states that upon submission of tax returns, all taxpayers subject to the documentation requirements that have entered into transactions with related entities must submit to the tax authorities information on the related entities they have entered into transactions with, the nature of the relationship between the entities, the type and amount of the transactions, and confirmation that the documentation requirements have been fulfilled in accordance with guidelines issued by the tax authorities.

Other documentation requirements stipulated in the regulation include information about the group, individual legal entities and operations, financial information, information about the nature and scope of transactions, information on services between related legal entities,

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information on comparability analyses and information on contracts that affect pricing in transactions between related entities such as advance pricing agreements conducted with tax authorities in other countries.

According to the regulation all five OECD transfer pricing methods are accepted, and other methods are not specifically excluded. Furthermore, the use of databases to conduct benchmarking analyses is not obligatory, nor do the tax authorities have any explicit authority to request such use.

A taxpayer subject to documentation must comply with the tax authorities' request for access to the documentation no later than 45 days after the request is made by the tax authorities. Such a request cannot be submitted until the deadline to file tax returns has passed.

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Chile´s Tax Reform and its Effects on Transfer Pricing Legislation

The lower house of Chile's Parliament in September 2014 approved all amendments made by the Senate to the tax reform bill presented by President Bachelet's government. Although the tax reform that was approved has wide-ranging implications for the Chilean tax system, which will gradually come into force from January 1, 2015, there were only two relevant changes to the transfer pricing legislation.

Increase of the TP adjustment applicable rate

In the event that the Chilean tax authorities determine that a taxpayer's transactions with foreign related parties are not carried out on an arm's length basis, it is entitled to impose a penalty at a rate of 40 percent (up 5 percent from 35 percent) on the resulting difference in income between the actual transaction and an arm's length transaction, plus a 5 percent fine.

Clarification on business restructuring

The second paragraph of Article 41E of Chile's Tax Law was modified to clarify that transfer pricing legislation also applies to business restructuring processes that entail a shift in assets and activities from a Chilean entity to a foreign one. The previous version of the paragraph could be interpreted to mean that transfer pricing legislation applied only to restructuring processes with countries or territories classified as tax havens by Chilean law.

It is important to highlight that Chile's transfer pricing legislation was introduced relatively recently in September 2012. Its main features can be summarized as follows:

Taxpayers that fall into at least one of the following categories must file a transfer pricing return (Form 1907):

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- Taxpayers that qualify as large and medium-sized companies and that engaged in transactions with foreign related parties;
- Taxpayers not included in the above-mentioned category that engaged in transactions with foreign related parties involving more than CLP 500,000,000 (USD 800,000 approx.); or
- Taxpayers that engaged in transactions with companies established in tax havens, as defined by Chilean law.

The transfer pricing method selected for analysis and results must be outlined in the transfer pricing return if the transaction amount exceeds a specific threshold (approximately USD 320,000 for 2015).

Chilean legislation contemplates the five transfer pricing methods listed in the OECD transfer pricing guidelines. However, it is also possible to use methods other than those in the OECD's guidelines.

Although taxpayers are not required to file transfer pricing documentation with the tax authorities, they must have documentation readily available in the event it is requested by the local tax authorities.

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Finland Considers Changes to Transfer Pricing Adjustment Rules

Finland's government issued a draft proposal on 7 January 2015 that would amend the transfer pricing rule in section 31 of the Tax Procedure Act, which prescribes the arm's length principle for related-party transactions.

The contemplated change follows a landmark decision issued by the Supreme Administrative Court in July 2014, in which the court held that section 31 only allows the Finnish tax authorities to make a transfer pricing adjustment (in accordance with the OECD transfer pricing guidelines); it does not permit the authorities to also recharacterize a transaction unless the conditions for application of the general anti-avoidance (GAAR) rule in section 28 of the Tax Procedure Act also are met. The case involved a situation in which the tax authorities recharacterized a hybrid instrument as equity (rather than debt) and disallowed a deduction for the related interest expense.

The draft proposal would add a specific GAAR clause to section 31 that would grant the tax authorities the power to recharacterize and disregard transactions when the legal form of a transaction does not correspond with its commercial substance. Although the draft generally targets financing-related arrangements, the actual wording of the proposed rule is not limited to financing transactions.

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Comments on the draft proposal are due on 20 February 2015. No effective date has been announced for the amended rule.

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US MTC Executive Committee to Formally Solicit State Commitments for Transfer Pricing Initiative

The Executive Committee of the Multistate Tax Commission (MTC) on December 12, 2014, passed a motion to formally solicit commitments from interested states for funding the initiative, termed the Arm's-Length Adjustment Service (ALAS), after discussing project facilitator Dan Bucks'[1] latest preliminary design for a multistate transfer pricing initiative. The following discussion outlines the background and recent developments in the ALAS initiative, examines the components of the preliminary design, outlines the potential path forward for the initiative, and suggests taxpayer considerations.

Background

The states have been working together to put some more tools in their audit toolbox to reattribute income under their version of IRC Section 482 and similar powers. As noted in the preliminary design discussed at the December meeting, states "have found the challenges posed by improper income shifting to be too costly to address on their own."[2] The ALAS initiative is designed to "pool [state] resources to more effectively, efficiently, and equitably address…" the challenges states face in dealing with transfer pricing.[3]

Development and Preliminary Design

The ALAS Advisory Group was charged with developing the ALAS initiative and has held a number of in-person meetings and teleconferences with participating states,[4] including a conference to meet with third-party transfer pricing firms, one or more of which may be utilized as part of the service. The ALAS Advisory Group's primary work product, the preliminary design, is now in its third iteration.[5] Through its various iterations, the core themes that ALAS would address have remained largely consistent. These include:

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[1] Dan Bucks was formerly the MTC executive director and Montana director of revenue.
[2] *See* Preliminary Design for an MTC Arm's-Length Adjustment Service, Dan Bucks, Project Facilitator (Dec. 2, 2014). (http://www.mtc.gov/getattachment/The-Commission/Committees/Executive-Committee/Executive-Committee-Agenda-12-2014/2014-12-02-Preliminary-Design-for-ALAS-Exec-Com-Ver.pdf.aspx)
[3] *Id.*
[4] Participating states include Alabama, the District of Columbia, Florida, Georgia, Hawaii, Iowa, Kentucky, New Jersey, and North Carolina.
[5] The prior versions of the design are posted at http://www.mtc.gov/The-Commission/Committees/ALAS.

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- **Transfer pricing analysis:** When there is a taxpayer-provided transfer pricing report, the MTC would hire or contract with economists for economic review of the report, as well as utilize auditors to perform non-economic activities, such as review of calculation errors and other non-economic technical issues.
- **Training:** The intent is to train auditors in a number of related areas, including how to identify issues, how and what information to obtain from taxpayers, and how to conduct the non-economic analysis noted above. Training efforts are already under way, with the MTC having sent a "call for training proposals" for outside assistance in developing a training program, which it suggests may take place in the first quarter of 2015.
- **Information Exchange:** The service would provide for exchange of taxpayer information related to transfer pricing issues and sharing of information for conducting joint audits.
- **Case Resolution and Litigation Support:** These activities include assisting states on strategies for appeals and litigation, providing expert witnesses in litigation, and other similar activities. The design also suggests a voluntary disclosure period early in the program.
- **Optional joint audits:** This envisions ALAS as a component of the MTC's existing Joint Audit Program. Three states recently joined the audit program (Pennsylvania, Rhode Island, and Iowa), and Bucks commented that at least one did so in anticipation of a transfer pricing component.

Other parts of the design, such as the staffing model and problem statement, have evolved to take into account suggestions from the participants in the ALAS Advisory Group meetings, including choosing a model with a lower first-year cost, and outlining the costs and benefits of the design.

Broad Intended Impact

Bucks highlighted in his presentation the relevance of the project to the varying tax regimes and provisions of all states. For example, he indicated that while the project would be important in analyzing transfer pricing studies in separate company reporting states, such analyses were not constrained to the US borders and the states could analyze and adjust the pricing in cross-border transactions. He added that such analyses could also be useful in conducting unitary relationship analyses to determine the members of a combined reporting group. Previous discussions have also highlighted the potential uses of transfer pricing as a component of state statutory intercompany add-back statutes, where transfer pricing could be used to identify indirect or embedded royalties.

The Path Forward

It seems that the "elephant in the room" for this project from the state perspective has been the potential cost of the service, estimated at $2 million per year. MTC Executive Director Joe Huddleston noted at the December Executive Committee meeting that he would not recommend that the project go forward without commitments from the states for complete funding of the project. The preliminary design projects a $25 million benefit per year return from the service, which Bucks asserted was a very conservative estimate.

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The project calls for a final design to be submitted to the full MTC at its annual meeting in July 2015 for ratification. The preliminary design establishes a four-year charter period, beginning in July 2015. The charter period would consist of a two-year "developmental stage" and a two-year "operational stage."

Considerations

While the ALAS initiative is the first MTC initiative specifically developed to address transfer pricing, it is not by any means the states' first foray in this area. Transfer pricing is increasingly an issue that arises within the context of state audits and has resulted in sizeable settlements, and in some cases litigation. So while the ultimate fate of the ALAS initiative may not be known until the MTC's annual meeting in July 2015, it is evident from the ongoing discussion that states have an interest in banding together to more effectively audit and address interstate and international transfer pricing issues. Furthermore, some activities, such as the above-noted transfer pricing training programs are already under way.

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.

Taxpayers may wish to consider whether this project, coupled with Executive Director Huddleston's recent call for an increased focus on uniform compliance projects, signals a shift away from uniform statute and regulation projects and toward uniform audit/enforcement and compliance projects.

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