FYI GGi GLOBAL ALLIANCE

GGI International Taxation News: Transfer Pricing Filing Obligations

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Welcome

Alan Rajah

Dear Reader,

Alan Rajah joined Lawrence Grant LLP in 1994 and he is involved in all areas of general practice, specialising in cross border tax planning, due diligence, mergers and acquisitions and inheritance tax planning. His client portfolio includes UK and overseas companies and individuals. Alan is the Global Vice Chair of the GGI International Tax Practice Group and a Trustee of British Foundation for International Reconstructive Surgery & Training (BFIRST).
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I'm thrilled that GGI International Tax Practice Group (ITPG) has produced this third special edition of the FYI – International Taxation Newsletter. In this edition, we will be looking at the issue of **Transfer Pricing Filing Obligations** and how these are currently regulated by the tax authorities in different jurisdictions around the world.

Transfer pricing is the method for pricing transactions between associated enterprises or, in some cases, within different divisions of the same company.

Depending on the terms of the transfer pricing documents, transfer pricing as an accounting practice can lead to savings for companies. However, this can also lead to challenges from the taxation authorities in which can pose both reputational and financial risks.

Tax authorities around the globe require that these transactions are treated as "arm's length" transactions, similar to how they would undertake business with any third-party company or organisation.

Transfer pricing can often be a cross-border practice, such as when divisions of a company are based in different countries. In practice, this can often lead to companies charging higher amounts for goods and services in countries where the tax rate is higher and less in countries where it is lower. This is an attempt to reduce the tax burden on the parent company and pass some of it to the subsidiaries or divisions based in other countries. Multinational companies are presently allowed to use transfer pricing to allocate earnings among their subsidiaries, though some

taxation authorities worry that these arrangements are being used to game the system.

As part of the GGI Global Alliance, we are all leaders in navigating the changing regulatory landscape for our clients. Undoubtedly, we are in uncharted waters following the global COVID-19 pandemic, with all the economic shocks and uncertainty stemming from this extended event. That said, we can take a long, hard look at how the landscape will likely to change and adapt accordingly to provide an exemplary service to our clients and protect their interests.

Looking at the near to mid-term future, most Governments are moving toward standardising document requirements to meet the OECD's Master and Local file requirements. There will also be a 30-day requirement for producing these documents. Some countries have already introduced an "International Dealings Schedule" (IDS), which would notify the tax office of material cross-border interactions that fall within the transfer pricing regime.

These changes will likely to offer a degree of flexibility for smaller and medium businesses. Indeed, an exemption already exists for many SMEs. Specific limits on employee headcount and turnover are considered when determining whether a UK-based company is considered to be Small, Medium or Large for taxation purposes.

In other financial jurisdictions, the relevant taxation authority, such as the Inland Revenue Service (IRS) in the USA, will also have their own rules and ways of dealing with transfer pricing. In most jurisdictions, transfer pricing agreements are fairly tightly regulated, and there are well-formulated guidelines on how they should operate. Ensuring that companies are operating to the highest standard in this regard is where we can add value for clients. This creates investor confidence, strengthens working relationships, and protects them from any potential reputational damage.

One of the most critical factors that often involves taxation authorities is ensuring that companies aren't facing double taxation over their transfer pricing arrangements. For many companies, being taxed in different countries for the same transaction would represent a significant financial hurdle. Hence, it is vital for us as an industry to ensure that this

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is something that is avoided wherever possible.

GGI ITPG members can assist companies that don't already have transfer pricing documents in place to work out the best way to proceed in ways that won't draw the ire of the taxation authorities in the countries they operate. There have been some significant, recent legal battles on the subject involving well-known international brands such as Rio Tinto (Australia), Maersk Oil and Gas (Denmark), Fiat Chrysler Finance Europe (European Commission), Mc Donald's France (France), ST Dupont (France), Blackrock (UK), Kellogg India (India), ConocoPhillips Skandinavia (Norway), as well more recent cases in USA involving 3M, Coca-Cola and Medtronic. It is apparent that transfer pricing rulings indicate that global tax authorities are not shying away from taking disputes to court as the amounts involved are significant.

It is important for multinational companies to seek professional advice when embarking on cross border work and I am pleased that members of GGI's ITPG are able to provide the required advice. I am pleased to note that members of GGI's ITPG members have developed a strong working relationship with members around the world and by working together on a cross border matters, we have been able to assist our international clients to meet their compliance obligations across multiple jurisdictions.

We are currently living in a complex and challenging world and I am extremely grateful to all GGI ITPG members, who are international tax experts in their respective countries, to have contributed towards this special edition. I would also like to thank Graeme Saggers of Nolands for initiating this topic as well as Barbara Reiss from GGI Head Office for coordinating this project.

I hope that you will be able to obtain an insight into how each country manages their transfer pricing filing obligations and would encourage you to contact the respective authors if you have any specific question in any particular

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jurisdiction.

Should you have any questions or comments on this subject, please feel free to contact me, and I will be happy to assist you.

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Responsible Editor &
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Australia

Ross Forrester

AUSTRALIA

by Ross Forrester

The Australian transfer pricing regime is robust and vigorously applied. Australia's corporate tax intake is relatively high, with 19% of total revenue from companies (compared to a 9% OECD average). Australia also sits in the bottom 25% of least-taxed OECD countries (2022 OECD Centre for Tax Policy). So, preserving the corporate tax intake through transfer pricing is a priority.

Transfer pricing is a key focus

Transfer pricing is a crucial compliance focus for the Australian Taxation Office (ATO), including restructures of Australian operations, artificially complex financial arrangements, excessive royalties, interest & fees, provision of services by Australian operations offshore with no charge, and allocating income and expenses to Australian operations with no substance.

While transfer pricing is focused on large businesses, around a third of SMEs are involved in international activities. So, transfer pricing is also a key priority for SMEs.

Introduction to Australian transfer pricing

The Australian transfer pricing regime rests upon the internationally accepted "arms-length" principle. Accepted methodologies include:

1. The comparable uncontrolled price (CUP) method
2. The resale price method
3. The cost-plus method
4. The transactional net margin method.

The ATO provides that the method chosen should be the one that is the most appropriate for the situation. The aim for identifying the method is to achieve consistency with the OECD 2015 publication, Aligning Transfer Pricing Outcome with Value Creation, Actions 8-10 – 2015 Final Reports.

If there is a difference between the form and substance of the

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services, the ATO can reconstruct the contract so that the substance prevails. If independent parties would not have entered a contract because of the contract's contrived nature, the ATO can adjust the terms of the contract to a commercially realistic contract.

When reporting on transfer pricing dealings, Australia adopts a country-by-country reporting approach by lodgement of an International Dealings Schedule for global business with a turnover exceeding AUD 1 billion. This includes notification of the percentage of dealings with documentation.

Relief from transfer pricing documentation

Australia offers relief for preparing transfer pricing documentation to reduce compliance costs. The relief has 7 simplified transfer pricing records keeping options available for:

- Small taxpayers;
- Distributors;
- Low value-adding intra-group services;
- Low-level inbound loans;
- Materiality;
- Technical services; and
- Low-level outbound loans.

To enjoy relief, taxpayers should lodge an International Dealings Schedule notifying the ATO that the taxpayer is choosing relief.

Sadly, we have seen many taxpayers review the relief criteria, self-assess that they qualify, and proceed to ignore the lodgement obligations. This then means that the taxpayer does not qualify for relief.

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As a guide, small taxpayer relief is available where the taxpayer:

1. Has a turnover under AUD 50 million;
2. Has not made sustained losses;
3. Has not had a restructure;
4. Does not have related party dealings, including royalty payments, license fees or research and development arrangements over AUD 500,000;
5. Has specified service-related-party dealings (either expenses or income) at less than 15% of the turnover; and
6. Is not a distributor.

A specified service-related-party dealing is merely not of a support nature – the service contributes significantly to creating, enhancing, or maintaining value. It requires using unique and valuable intangibles or the assumption of control of substantial risk or gives rise to significant risk for the service provider.

Further, transfer pricing is a key focus for thinly capitalised entities. While Australia has no thin capitalisation rules where the interest paid is less than AUD 2 million, taxpayers are still required to support the market value interest rate.

Transfer pricing documentation requirements

The need for documentation is approached with a practical sense of what a taxpayer should reasonably expect to retain. The complexity of the transaction, together with the materiality of risk, is paramount.

When a taxpayer is documenting their transfer pricing treatment, they have 5 key questions to consider and answer:

1. What are the actual conditions that are relevant to the matter?
2. What comparable circumstances are relevant to identifying the arm's length conditions?
3. What methods are used to identify the arm's length conditions?
4. What is the arm's length conditions, and is the transfer pricing treatment appropriate?
5. Have any material changes and updates been identified and documented?

For taxpayers with international-related party dealings of more than AUD 2 million, the Australian local file *and* Section A of the International Dealings Schedule must be lodged. The local file is due within 12 months of the end of the income tax year and can only be filed electronically.

The Local File and International

Dealings Schedule must disclose information about international related party dealings, the transaction's magnitude, and the transfer pricing documentation level.

A Short Form Local File exists for taxpayers whose international related party dealings are less than AUD 2 million, and they meet the simplified transfer pricing record-keeping criteria for small taxpayers and the criteria for materiality. There are also requirements regarding the type of related party dealings. Otherwise, the Local File will need lodgement that includes the Short Form Local File information.

Several Practical Compliance Guidelines allow taxpayers to self-assess the ATO's risk perception with specific transfer pricing positions.

Advance Pricing Arrangements (APA)

A taxpayer can enter an APA with the ATO to reduce transfer pricing risk. This will only occur for material dealings. However, simply because a taxpayer qualifies for Simplified Transfer Pricing Record Keeping does not mean the transaction is not material.

Typically, most APA's require that a taxpayer prepare and lodge an annual compliance report (ACR). It ordinarily contains details of the actual results of the taxpayer to show compliance with the APA.

Given the technical difficulties of documentation, our approach is to identify one of the 7 ways taxpayers can adopt the simplified record-keeping regime.

Penalties for non-compliance

The Australian Taxation Office (ATO) has a formal approach to encouraging tax compliance and governance rather than imposing penalties. And the audit focus is on significant global entities or those whose tax paid is lower than industry norms or entities who have recently restructured in a way that materially affects the related party's international dealings.

The penalties for transfer pricing adjustments range from 10% to 50%. The lower range requires a reasonably arguable position. The higher range is where the arrangement was entered with the sole or dominant purpose of a transfer pricing benefit.

You need documentation to argue lower transfer pricing penalties. The lack of documentation is not reasonably arguable.

If the entity is a Significant Global Entity, the penalties can be double.

Canada

Julian A. Emmanuel & Joe Moëd

CANADA

by Julian A. Emmanuel & Joe Moëd

I. Introduction to Transfer Pricing in Canada

a. Transfer pricing rules

Canada's transfer pricing rules, found in Section 247 of the Income Tax Act (ITA), apply to Canadian taxpayers who enter into transactions with non-arm's-length non-residents.

The legislation is supplemented by various transfer pricing memoranda (TPM) issued by the Canada Revenue Agency (CRA). However, in the case of a dispute, the guidance in the TPMs is not binding on the courts.

The transfer pricing legislation does not

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contain any concept of materiality, or a threshold below which transactions are exempt.

b. Transfer pricing methods

Canada's domestic legislation does not specify any particular method to be used to determine arm's length transfer prices. However, the domestic guidance generally accepts any of the methods found in the OECD Transfer Pricing Guidelines (TPG), namely:

1. Comparable uncontrolled price
2. Resale price
3. Cost plus
4. Transaction net margin
5. Profit split

While not enshrined in legislation, various CRA guidance has outlined the CRA's view, consistent with the TPG, that the traditional transaction methods (1, 2, and 3 above) are preferred over the transactional profit methods (4 and 5), provided sufficient reliable comparable data is available.

c. OECD guidance

As a member of the OECD, Canada's transfer pricing rules generally conform to the OECD TPG, and encourage the use of TPG methodologies to ensure transactions are treated at arm's length. However, while Canada's transfer pricing rules encourage the use of the OECD TPG, the TPG has no legal force in Canada, and is for guidance only.

d. Reporting requirements

Taxpayers are not required to submit their transfer pricing documentation to the CRA in the normal course of filing their annual corporate tax return.

However, where transactions with non-arm's-length non-residents exceed CAD 1 million in aggregate, taxpayers must file **Form T106** (Information Return of Non-Arm's-Length Transactions with Non-Residents) within 6 months of their year-end, reporting the transactions and balances with the applicable non-resident.

On this form, taxpayers also certify that they have prepared "contemporaneous documentation" with respect to the reported transactions, which must be provided to CRA within three months upon written request. It is therefore important that this contemporaneous documentation (as set out in II.a below) be maintained so that it can be provided on request.

Finally, taxpayers with consolidated group revenues of at least EUR 750 million must also file Country-by-Country Reporting (CbCR) within 12 months of their year-end. Canadian CbCR reporting legislation generally conforms to OECD model legislation.

II. Transfer pricing documentation in Canada

a. Preparation of transfer pricing documentation

The requirements to prepare and maintain transfer pricing documentation, commonly referred to as "contemporaneous documentation", are contained in Subsection 247(4) of the ITA.

This "contemporaneous documentation" must contain a description of the transactions that is complete and accurate in all material respects, including:

1. The property or services to which the transaction relates;
2. The terms and conditions of the transaction;
3. The identity of the participants in the transaction and their relationship to each other;
4. The functions performed, the property used or contributed, and the risks assumed for the transaction by the participants in the transaction;
5. The data and methods considered and the analysis performed to determine the arm's length transfer prices for the transaction; and
6. The assumptions, strategies, and policies, if any, that influenced the determination of the arm's length transfer prices for the transaction.

b. Master and "Canada" local file

Canada's domestic transfer pricing regulations **do not** require the preparation of a Master and Local file in accordance with Annex I & II respectively of Chapter V of the TPG.

c. Penalties

Under the ITA, the CRA may adjust a taxpayer's transfer prices if it is determined the transfer prices do not reflect the terms and conditions that would exist between persons dealing at arm's length.

If the net result of these adjustments exceeds the lesser of 10% of the gross revenue for the year and CAD 5 million, the taxpayer is liable to a penalty of 10% of the amount of the adjustments.

Furthermore, a late-filed T106 attracts penalties of CAD 25 per day to a maximum of CAD 2,500 for each individual T106 slip required.

In general, the CRA can review and reassess a corporation's tax return within

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three years from the original notice of assessment if the corporation is a Canadian-controlled private corporation, or within four years for all other types of corporation.

However, these reassessment periods are extended for **three more years** in the case of transactions between a Canadian taxpayer and a non-arm's-length non-resident, and accordingly, care must be taken to maintain appropriate documentation for at least 6 years.

III. Economic analysis and how to demonstrate an arm's length result

The arm's length principle contained in the OECD TPG is enshrined in Section 247 of the ITA, where an arm's length transfer price is defined as "an amount that would have been a transfer price in respect of the transaction if the participants in the transaction had been dealing at arm's length with each other".

In general, the CRA's guidelines and the TPMs regarding economic analysis and how to demonstrate an arm's length result follow the principles set out in the OECD TPG.

IV. Advance pricing arrangements (APAs), dispute avoidance and resolution

The CRA runs an Advance Pricing Arrangement (APA) programme which assists taxpayers to determine appropriate transfer pricing methods for transactions with non-arm's-length non-residents. The APA is entirely voluntary, and there is no legal requirement to enter into an APA with the CRA. The objective of the programme is to provide taxpayers with increased certainty regarding their transfer pricing arrangements. According to the 2021 annual report prepared by the APA, the average time to conclude a bilateral APA with the CRA was 49.4 months.

If a taxpayer believes the CRA has misinterpreted the facts or applied the law incorrectly, the taxpayer has the right to object within 90 days of the receipt of the relevant notice of assessment or reassessment. The objection should include a detailed description of why the taxpayer disagrees, as well as relevant facts and supporting documentation.

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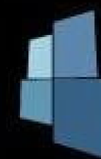

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Czech Republic

Jakub Vršecký & Tereza Benediktova

Czech Republic

by Jakub Vršecký & Tereza Benediktova

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Transfer pricing rules

Transfer pricing rules in the Czech Republic are governed by the Czech Income Tax Act, which implements the principles of the OECD Transfer Pricing Guidelines.

The General Financial Directorate and the Ministry of Finance issued decrees explaining recommended practices on transfer pricing. These decrees are considered to be general recommendations and interpretation guidance, rather than strictly binding legal sources. The relevant guidelines on transfer pricing are:

- **D-10** – on low value-added services provided between related persons/associated enterprises;
- **D-32** – on a binding ruling regarding the method for determining the transfer price between related parties;
- **D-34** – on the application of international taxation standards on transactions between related parties (transfer pricing); and
- **D-334** – on the scope of transfer pricing documentation.

Transfer pricing methods

Decree D-34 does provide some sequencing in the TP method selection process by suggesting that the selection process should begin with consideration of the **comparable uncontrolled price (CUP) method**, followed by consideration of other traditional transactional methods, and, finally, consideration of transactional profit methods. The decree, however, also states that sometimes it may be more appropriate to select a transactional profit method than a traditional transactional method, such as in cases where each party to the transaction provides a unique and valuable contribution or where information on the gross margins of unrelated parties is not available.

The CUP method is based on a proper comparative analysis, including an analysis of

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functions and risks, and cannot be applied in situations where an identical product is found but the parties to the transaction perform different functions and bear different risks.

The **profit split method (PSM)** may be used where the unique and distinct contribution of all parties to the transaction can be identified – for example, through the ownership of a unique tangible or intangible asset, and at the same time where the parties involved contribute high added value and bear corresponding risks in the functions performed.

Other methods that can be used are the **resale price method (RPM)**, the **cost plus method (CPM)**, or the **transactional net margin method (TNMM)**.

Decree D-10 includes only those intragroup services with low added value that do not constitute the core business of the entities, are a routine function and do not constitute a significant cost or income of the undertakings concerned.

OECD guidance

Regarding transfer pricing in the Czech Republic, key principles and concepts from the OECD guidelines are applied. These include the requirement to determine market prices for related party transactions, and to conduct comparability analysis to determine these prices. (See previous points.)

Reporting requirements

In the Czech Republic, there is no legal obligation to have transfer pricing documentation submitted to the tax administrator within certain deadlines. In practice, however, taxpayers must have it ready, or

at least be able to prepare the documentation very quickly, in case of a tax audit. They are obliged to submit this documentation to the tax authorities within 30 days of receiving a written request.

The law also allows simplifications in marginal cases, and the court has ruled that the complexity of the transfer documentations should correspond with the complexity of the relations between associated parties.

Transfer pricing documentation in the Czech Republic

a. Preparation of transfer pricing documentation

Before assessing whether the transaction satisfies the arm's length principle, it is necessary to assess whether the transaction took place (the substance test), and whether it benefited the taxpayer (the benefit test). If the answer to both questions is yes, the third test (the arm's length test) can be applied – in other words, to examine the conditions and whether the transfer prices comply with the arm's length principle.

b. Master and “Czech” local file

A master file is a file containing information on an entire group of companies which is uniformly applicable to all EU members. This information should include all economic facts and provide a comprehensive overview of the multinational company. The package documents the transfer pricing policy for the whole group and explains all internal business relationships.

The local file should, on the

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other hand, contains the analysis proving the arm's length principal in concrete transactions. There is a general consensus that the local file alone is sufficient in relations between associated parties with simple organisational structure.

c. Penalties

There is no specific penalty for shortcomings in transfer pricing documentation. The general penalties applicable in tax procedures also apply in the case of transfer pricing inadequacies, and the expected outcome of poor documentation is the arrears and penalty from wrongly assessed income taxes.

Advanced pricing agreements (APAs)

APAs are generally and commonly used by multinational enterprises (MNEs), and provide legal certainty for the parties as the outcome ruling is binding for the tax office. Decree D-32 focuses on binding decisions, and the desired structure of the request. A binding assessment decision means a certain degree of certainty for the taxpayer about how the tax administration will assess the method of establishing the price between related parties, or the method of determining the tax base of a non-resident taxpayer on income earned through a permanent establishment located in the Czech Republic.

The process of obtaining this binding agreement in the Czech Republic is quite long – months, in some cases more than a year – and its validity is 3 years.

France

Viviane Moro

FRANCE

by Viviane Moro

In 2020, despite the global pandemic, the French tax authorities raised EUR 1.2 billion because of the implementation of anti-transfer pricing provisions. It is therefore crucial to take a close look at French regulations which provide a tight framework in this particular area.

I. Introduction and brief overview of transfer pricing regulations in France Transfer pricing rules

As a founding member of the Organisation for Economic Co-operation and Development (OECD), France has signed up to its transfer pricing principles.

Transfer pricing methods

France follows the five different transfer pricing methods recommended by the OECD. A French company can choose the remuneration method that best suits the type of function performed from the three so-called "traditional" transaction-based methods: the comparable arm's length method (CUP), the resale price method, the cost plus method, and the two so-called "transaction-based" methods, based on profits – the profit-sharing method and the net margin method.

Any method used by the company is, in principle, acceptable to the tax authorities if it is justified, consistent with the duties performed and risks assumed, and if the remuneration complies with the arm's length principle.

OECD guidance

Following the international consensus on the valuation of international transactions between affiliated companies, the OECD transfer pricing guidelines provide guidance on the implementation of the arm's length principle. According to this principle, the price charged between

dependent companies must be the price that would have been charged on the market between two independent companies.

Reporting requirements in France

a. Annual declaration of transfer pricing policy

Companies exceeding certain thresholds (turnover or balance sheet totals) must provide the tax authorities with simplified documentation on transfer pricing policies within the group every year.

This obligation applies to:

- Legal entities with annual turnover of EUR 50 million or more (excluding tax or gross assets);
- Legal entities directly or indirectly holding (at the close of the financial year) over half of the capital or voting rights of a legal entity meeting one of the conditions mentioned in the previous point; and
- Legal entities of which over half of the capital or voting rights at the close of the financial year are directly or indirectly held by a legal entity meeting one of the conditions mentioned above.

Companies that do not conduct any transactions with affiliates established abroad, and companies that conduct transactions with affiliates established abroad for an amount of less than EUR 100,000 per type of transaction, are exempt from the obligation to file this declaration.

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b. Country-by-country reporting

In France, the obligation to submit country-by-country reporting (CbCR) was introduced in the 2016 Finance Act. This entailed the transposition into domestic law of the OECD recommendation on CbCR reporting, which was adopted in the European Union directive (Directive 2016/

881/EU) of 25 May 2016.

This obligation applies to:

- Groups established in France with consolidated, annual pre-tax turnover of over EUR 750 million, that prepare consolidated accounts, and which own and control companies or branches outside France for which separate financial statements are prepared;
- Groups established in France that do not prepare consolidated accounts but meet the other criteria mentioned above; and
- Companies established in France which are part of a foreign group meeting the above criteria, when they have been designated by the group to file the return, or if they are unable to show that another French or foreign entity has been designated to file the return.

If a legal entity is established in France and owned by one or more legal entities located in France already required to file this declaration, or if the legal entity is established outside France and required to file a similar declaration under foreign regulations, the legal entity is exempt from filing a declaration in France.

II. Economic analysis and how to demonstrate an arm's length result

a. Functional analysis

To ensure that transfer pricing complies with the arm's length principle, it is first necessary to conduct a functional analysis of the company: its functions, the risks it bears, its role within a group, and the tangible and intangible assets it owns or uses. Only after this analysis has been completed is it possible to determine the most appropriate method for remunerating an activity, and determine the income and costs of the assets underpinning the calculation basis.

b. Determining the arm's length price

After the functional analysis, the company can determine the most appropriate method for remunerating the activity. It must then compare the price it has determined as the arm's length price with the price that would be agreed on the market between two independent companies for an identical transaction.

The methods used by the company, when supported by relevant methodological, accounting, economic and documentary evidence, are considered by the French tax authorities and enable the documentary obligation to be met.

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III. Transfer pricing documentation in France

a. Preparation of transfer pricing documentation

In France, the obligation to have full transfer pricing documentation applies to "legal entities established in France" (including foreign legal entities with a permanent establishment in France) as follows:

1. Have annual pre-tax turnover or gross balance sheet assets of EUR 400 million or more;
2. Directly or indirectly hold at the close of the financial year over 50% of the capital or voting rights of a legal entity meeting one of the conditions referred to in 1);
3. More than 50% of the capital or voting rights at the close of the financial year are directly or indirectly held by a legal entity meeting one of the conditions referred to in 1); or
4. Is part of a group covered by the tax consolidation system where the group includes at least one legal entity meeting one of the conditions mentioned in 1), 2) or 3).

b. Master and France local file

Transfer pricing documentation must include two files:

1) Master file

The master file contains general information on the group's global activities and transfer pricing policy. It must include 5 sections: the group's organisational structure; a description of its business area(s); information on its intangible assets; inter-company financial activities; and its financial and tax position.

2) Local file

The local file is made up of 3 sections: entities in France, controlled transactions, and financial information.

This documentation is made available to the tax authorities, and a periodic reassessment of this documentation must be performed to ensure that the transfer pricing method chosen remains the most appropriate. Also, where there are grounds for presuming an indirect transfer of profits by a company (including where the company is not under an obligation to have full documentation), the tax authorities may require the company to provide information and documents relating to the transfer pricing method.

c. Penalties

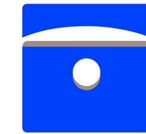
If a company fails to produce the required documentation or only produces partial documentation, the authorities will send it formal notice to produce or complete it within 30 days.

Failure to provide a response, or merely providing, a partial response will result in a fine of no less than EUR 10,000 for each financial year audited, and, depending on the gravity of the omissions, the higher of the following two amounts: 0.5% of the amount of the transactions concerned by the documents, or additions that have not been made available to the authorities, or 5% of adjustments to net profit relating to the above transactions.

IV. Advanced pricing agreements (APAs), dispute avoidance and resolution

a. Advance pricing agreement

The advance pricing agreement allows French companies to secure their transfer prices by obtaining a position from the tax authorities on the transfer pricing method applied to transactions. In this case, the



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authorities are bound by the opinion they issue. In general, this agreement is valid for 5 years.

b. Bilateral agreement

An advance agreement procedure for transfer pricing based on the mutual agreement procedure clauses in bilateral tax treaties allows companies to obtain a formal position from the tax authorities on their pricing policy with their foreign subsidiaries.

The agreement concerns the method to be used and not the actual setting of transfer prices within the multinational group. The term of the agreement may not be less than 3 years or more than 5 years.

In the event of a tax audit bearing on the financial years covered by the agreement, the terms of the agreement cannot be challenged.

FYI GGi GLOBAL ALLIANCE

Germany

Oliver Biernat

GERMANY

by **Oliver Biernat**

Oliver Biernat is Founder and Managing Partner of Benefitax. He is a German Chartered Accountant, Certified Tax Advisor and Specialist Advisor for International Taxation with more than 30 years of experience. Since 2008, he has chaired GGI's International Taxation Practice Group (ITPG), increasing its size to more than 570 experts from 90 countries in the process. **Contact Oliver**

I. Introduction and brief overview of transfer pricing regulations in Germany.

Many foreign investors think that transfer pricing (TP) rules and documentation prepared for their home country can be used for their German subsidiary or permanent establishment. This is normally not the case. German tax authorities insist that transfer prices be determined, and, if necessary, also documented, according to special German rules.

a. Transfer pricing rules

The general arm's length rule can be found in Section 1 of the AStG (Foreign Tax Code), stating that transfer prices must be created in a way independent third parties would have agreed on. Several ordinances, and especially the "Administrative Principles Transfer Pricing", which are binding for the tax authorities but not for the taxpayer and the courts, provide a good insight into how you should proceed if you want to avoid conflicts with the tax authorities. All agreements between related parties should be in writing and signed by a legal representative of each party **before** they come into force.

b. Transfer pricing methods

Allowed are the CUP, resale minus method, cost plus method, TNMM, and, in special cases, profit split methods. It is obligatory to choose the most appropriate method and to justify your choice. Usually this should be done by conducting functional and risk analyses. For the cost plus method, a 5% margin is usually

accepted. Quarterly adjustments when profit level indicators are out of the range of comparables are allowed and required.

c. OECD guidance

OECD Transfer Pricing Guidelines have not been implemented in German law but can provide some orientation in cases where there is no specific, prevailing German rule. The authorised OECD approach for the attribution of profits to permanent establishments is only applied in cases with OECD countries, or when the double tax treaty (DTT) contains the new Article 7 of the OECD MTC 2010 and later.

d. Reporting requirements

Taxpayers must provide information and documents in order to clarify matters relevant to taxation, even if this information is only available abroad. As of now, the tax authorities only ask for TP documentation within a tax field audit. The deadline to submit is 60 days, and 30 days in case of extraordinary business transactions.

For fiscal years starting after 31 December 2024, or in cases where a tax field audit has been announced after 31 December 2024, the tax authorities can also ask for TP documentation for all prior years at any time, and the deadline will be 30 days in any case.

As the 30- and 60-day deadlines are usually not sufficient for the preparation of TP documentation, it is recommended to prepare it once the thresholds are exceeded and update it whenever there are material changes, and at a minimum, at least annually.

II. Transfer pricing documentation in Germany

a. Preparation of transfer pricing documentation

How to document transfer prices is outlined in Section 90a para 3 of the general tax code and in the profit accrual recording ordinance (GAufzV). "Small entities" do not have to prepare and submit transfer pricing documentation, but instead must present all underlying business papers related to the transfer price was determined. However, transfer prices of small entities will still be checked by the tax authorities.

The condition for a small entity is fulfilled if: i) the total of all revenue for the delivery of goods of all German entities of a group with related parties abroad does not exceed EUR 6 million; and ii) all revenue for services with related parties does not exceed EUR 600,000 per annum.

b. Master and German local file

- All companies with related parties abroad that are not small entities as defined above must prepare a local file.
- A master file must be prepared by companies with related parties abroad with a threshold on returns of EUR 100 million.
- Local and master files must be provided in German, or, if it has been explained and accepted by the tax authorities beforehand, in another language. In the latter case, a translation into German may be required upon request, or in a case of domestic court procedures.
- Country-by-country reports (CbCRs) with a threshold of EUR 750 million in the group financial statements will be accepted in English.

c. Penalties

In cases where the transfer pricing documentation is not provided or provided insufficiently, the authorities are able to estimate the respective income and assess surcharges. It is common that a tax auditor will state that the taxpayer has done something wrong, and will therefore estimate the profits in a percentage of the turnover.

If the taxpayer fails to cooperate with a qualified request for information, additional penalties may be assessed. In severe cases, and for larger companies with either more than EUR 12 million turnover, or companies that belong to a group with consolidated group turnover of at least EUR 120 million, the penalties can reach up to EUR 3.75 million.

III. Economic analysis and how to demonstrate an arm's length result

The taxpayer should state all facts that are of tax significance for the agreement of terms and conditions for business transactions, in particular, transfer prices. In addition to the presentation of business transactions, the record-keeping obligation also includes the economic and legal basis for an arm's length agreement of conditions, in particular transfer prices, as well as information on the time of the transfer price determination, the transfer price method used, and the arm's length data used.

The taxpayer should prepare records for each business transaction in accordance with the transfer pricing method they have chosen, and use comparative data, to the extent available. This will include data on comparable business transactions which the taxable person or a person close to them has concluded with third parties, and on comparable business transactions

between third parties. In addition, records must be kept of internal data that enable a plausibility check. The weighting of the functions exercised, the risks assumed and the material assets used by the taxpayer and their related parties must be consistent, and must be presented in a quantitatively comprehensible manner for each party involved in the business transaction.

IV. Advanced pricing agreements (APAs), dispute avoidance and resolution

There are bilateral and multilateral APAs as well as mutual agreement procedures and joint audits by tax authorities from several countries involved. An APA programme is in place in Germany whereby the duration of an APA is 5 years with rollback allowed.

In principle, the German tax authorities are hesitant to issue unilateral, advance tax rulings on transfer pricing issues. The tax authorities require very detailed documentation from the taxpayer to describe the specifics, and how they could be treated tax-wise from all points of view. A decision on how the taxpayer would approach a situation would be paid for by the taxpayer, and if the situation changes later on and the prerequisites under the advanced ruling were no longer met, the tax authorities argue that this would no longer be covered by the advance ruling. As a result of this lack of clarity, in 2019 for example, there were only 89 applications requests for APA procedures and only 25 completed APAs in Germany.

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FYI GGi GLOBAL ALLIANCE

India

Ashish Bairagra

INDIA

by **Ashishkumar Bairagra**

Ashishkumar Bairagra has been in practice and a partner of the firm since 2001. He handles international taxation matters, inbound and outbound investments, and consulting assignments. He offers consulting services to various family businesses and HNIs on transition, expansion, exits, and entrepreneurship. Ashishkumar is the global vice chair of GGI's International Taxation Practice Group (ITPG). **Contact Ashish**.

Introduction and a brief overview of transfer pricing regulations in India

India introduced transfer pricing (TP) regulations as early as 2001. The main objective of TP regulations was clearly defined to be "special provisions relating to avoidance of tax". The regulations were meant to serve as a tool to prevent the erosion of India's tax base, and, with the growing presence of foreign companies in the manufacturing and services industries, to ensure that India received its fair share of taxes. India was happy to be the global factory for the world, but did not want to become one at the cost of its tax revenue.

Between 2001 and now, India has constantly reviewed its TP regulations, adopted changes early on, and in many cases has led tax authorities around the world to tax international transactions which previously would not have taxed in other countries – the most famous example being the indirect transfer case of Vodafone in India. Concepts of Advance Pricing Mechanism, Safe Harbour Rules, use of multiple year data, adoption of BEPS Action Plan 13, providing for secondary adjustments, and the angel tax, to name a few, were adopted by India early on when these were introduced internationally. In fact, India also applies TP regulations to "specified domestic transactions" to keep domestic tax evasion and tax planning in check, between taxable and tax-free incomes.

a. Transfer pricing rules

India has adopted the principle of "arm's length price" (ALP), and TP regulations revolve around comparing, rather than justifying, the actual price and the ALP for all international transactions between "associated enterprises", and for

all specified domestic transactions. The determination of ALP is heavily dependent on benchmarking analysis which should be conducted as per the TP regulations and TP documentation rules. TP regulations apply to every single international transaction between associated enterprises with no minimum threshold, hence even low value transactions or a single transaction between associated enterprises is covered by TP regulations.

b. Transfer pricing methods

India recognises the globally accepted and used methods for determining the ALP:

- Comparable uncontrolled price method (CUP);
- Resale price method (RPM);
- Cost plus method (CPM);
- Profit split method (PSM);
- Transactional net margin method (TNMM); and
- Any other such appropriate method as may be prescribed by India's Central Board of Direct Taxes.

The last method provides some flexibility to justify the price actually charged/paid with the price that would have been charged/paid for the same or a similar uncontrolled transaction between non-associated enterprises under similar circumstances, and considering all the facts. The choice of selecting the "most appropriate method" is also required to be justified as part of the ALP determination.

c. OECD guidance

Though India is not a member of the OECD, and Indian TP regulations do not mention the OECD TP guidelines, India's TP principles and regulations are based on the OECD TP guidelines and BEPS Action Plan. In various disputes, where clear indications were not available in TP regulations or where there were no

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precedence cases, judicial rulings have placed reliance on the OECD TP guidelines or judicial rulings in other countries based on OECD TP guidelines.

d. Reporting requirements

Every taxpayer who has entered into "international transactions" or a "specified domestic transaction" is required to obtain a report from a chartered accountant every year (the format of such a report is defined in Form 3CEB), which provides details of all such transactions and the ALP of such transactions, and which is certified by the chartered accountant. This is generally referred to as a Transfer Pricing Report. This report must be filed electronically for each financial year (which ends on 31 March every year) on or before 31 October – in other words, within 7 months of the end of the fiscal year.

Generally, the basis of the TP report is TP documentation maintained by the taxpayer, and is mandatory if the aggregate value of international transactions exceeds INR 10 million, or if specified domestic transactions exceed INR 200 million. Though it is not a reporting requirement, invariably, tax authorities will require TP documentation to be submitted at the time of an assessment.

In cases where country-by-country reporting (CbCR) applies, the master file should be filed electronically in Form 3CEAA on or before 30th November every year too.

Transfer pricing documentation in India

a. Preparation of transfer pricing documentation

Rule 10(D) of the Income-tax Rules, 1962, prescribes the extent of information and documents which form part of TP documentation. These include, but are not limited to, the ownership structure of the group, profile of the group with a list of all entities, industry analysis and outlook, details of transactions undertaken in India, broad terms of the agreement and comparability with uncontrolled transactions, detailed Functions, Assets, and Risk (FAR) analysis, justification for selecting the most appropriate method, benchmarking analysis with details of the various filters, and numeric tables of comparables selected after each filter.

b. Master file and local file

A master file is required to be filed with the Indian tax authorities if the group's consolidated global turnover exceeds INR 5 billion and international transactions in India exceed INR 500 million (INR 100 million in case of intangibles). Over and above the TP documentation, the master file information should include: key drivers of profits; entities involved in R&D; entities holding intangibles; a description of the supply chain; details of financing arrangements; and the groups' consolidated financial statements.

For the local file, the

maintenance of TP documentation described above is considered sufficient.

c. Penalties

Indian tax authorities have always been harsh on non-compliance and hence penalties form part of the TP regulations too. The penalties/ fines for the following items are as follows:

1. Failure to maintain specified information/documents, failure to report transactions in Form no. 3CEB and TP documentation, maintenance of incorrect information, and failure to submit information during assessment:

- 2% of the value of international or domestic transaction

2. Failure to file Form no. 3CEB:

- INR 100,000

3. Failure to furnish master file:

- INR 500,000

4. Failure to furnish CbCR by due date:

- INR 5,000 per day for one month; INR 15,000 per day after one month;
- INR 50,000 per day after the date of service of penalty order

5. Failure to produce information before the prescribed authority for the purposes of filing the CbCR:

- INR 5,000 per day for one month: INR 50,000 per day after the date of service of penalty order

6. Concealment of income or furnishing inadequate particulars of income with respect to the arm's length price (ALP) adjustments:

- 100% to 300% of the tax sought to be evaded

7. Underreporting or misreporting of income:

- 50% of tax amount in cases of underreporting; and 200% of tax amount in case of misreporting

It is important to note that these penalties can be waived where one is able to demonstrate reasonable cause either to support a position or for the delay in filings. An appeal can also be filed before the appellate authorities against an order imposing a penalty.

Economic analysis and how to demonstrate arm's length price

Indian tax authorities place a lot of relevance, first, on the FAR analysis to determine whether the international transactions can be compared to uncontrolled transactions, and, second, on the benchmarking analysis to determine whether the selection of comparables and the publicly available information on these comparables has been adequately considered at the time of preparing the TP documentation. In practice, the tax authorities will independently conduct the benchmarking analysis on a

reputed benchmarking TP database. FAR concepts bright line test for advertising and marketing; and significant economic presence is commonly used in India to justify the ALP, and used by tax authorities in tax litigations.

Advanced pricing agreements (APAs), dispute avoidance and resolution

India has a robust mechanism for dispute avoidance and resolution. The APA programme was introduced as early as 2012, and offers validity for 5 prospective years with an additional rollback option for 4 previous years. It also provides for unilateral, bilateral, or multilateral APAs, and there are no value thresholds to apply for an APA.

In line with India's growing trade in certain sectors, Safe Harbour Rules prescribe a detailed list of transactions and the percentages for each of these transactions which form the tolerable limits for variance between the actual price and the ALP determined.

Last but not the least, India also recognises Mutual Agreement Procedures (MAP), taking cues from the OECD guidelines and BEPS Action Plan 14.

Italy

Matteo Bedogna

ITALY

by Matteo Bedogna

Matteo Bedogna is partner and head of the international tax department. He specialises in transfer pricing and international tax structures. He currently assists a number of multinational groups, both Italian and foreign based. Contact Matteo.

Overview

Italy, as a member country of the OECD, has adopted rules inspired by the OECD Transfer Pricing Guidelines. Consequently, the transfer pricing methods accepted by the Italian Tax Authority (ITA) are the same as those outlined by OECD (i.e. comparable uncontrolled price (CUP), cost plus, resale price, transactional net margin, and profit split methods).

Only where one of the OECD transfer pricing methods is not applicable, may the taxpayer adopt a different method. On the other hand, where the taxpayer has selected one of the OECD methods and proved it is the most appropriate to the circumstances of the case, ITA is bound to use that method.

As to the arm's length prices that ITA considers to be in accordance with the arm's length principle, only recently has the full range of arm's length values been recognised as fully compliant, whereas in the past it was common practice to raise objections when the price charged in intercompany transactions deviated from the median value.

Reporting requirements

Apart from the preparation of the transfer pricing documentation, which is **optional**, reporting requirements imposed on Italian taxpayers are very limited.

In the tax return it is **mandatory to disclose the amount of cross-border, intragroup transactions** (income and expenses) without further reference to the transfer pricing methods selected.

It is also necessary to indicate whether the TP document has been **prepared for the**

financial year to which the tax return relates.

TP documentation

While all Italian taxpayers engaging in cross-border transactions with related parties must comply with the OECD arm's length principle, **the preparation of TP documentation remains a mere option**.

However, if prepared on time and in compliance with domestic regulations, **TP documentation guarantees the so-called penalty protection** – in the event of transfer pricing adjustments, **no penalties will be imposed**.

Penalties from transfer pricing adjustment range from **a minimum of 90% to a maximum of 180% of the additional income tax** deriving from the adjustment.

Given the very heavy penalties imposed, preparing TP documentation is absolutely appropriate for medium sized or large multinationals, where even a small TP adjustment can result in a significant number of penalties.

TP documentation consists of a **master file** and a **country file,** whose structure and contents are set out by domestic regulations and are consistent with the OECD Guidelines.

It is interesting to note that as of the financial year 2020, **the master file could**

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be prepared in English, thus allowing Italian subsidiaries of multinational groups to use any documentation prepared by the group's headquarters.

In contrast, the **country file** must be prepared exclusively in **Italian**.

Deadline to prepare TP documentation

To guarantee the penalty protection, **TP Documentation must be prepared by the deadline for e-filing the annual tax return**, i.e. the last day of the eleventh month following the end of the financial year.

Therefore, for taxpayers who adopt the calendar year – the vast majority in Italy – this deadline is 30 November.

By this date, the TP documentation must be digitally signed by the legal representative of the taxpayer and a **time stamp must be affixed** to certify the timeliness of the documentation. Failure to affix the time stamp will not allow the taxpayer to benefit from penalty protection.

The TP documentation must be delivered to the Italian Revenue Agency within 20 days of the relevant request, whereas if during a tax audit a taxpayer is required to provide additional or supplementary information, it must be provided within 7 days.

Practical tips for a TP audit

As mentioned, **TP documentation (master file and national document) is the best protection tool during a tax audit**, especially for those taxpayers with a significant amount of intragroup cross-border transactions.

It is very important that TP documentation clearly sets out the steps taken in performing the TP analysis, and focuses on how the comparable taxpayers were selected and the "arm's length range" of comparable prices was built, considering that:

- ITA uses the same TP databases as those used by taxpayers, and therefore can easily replicate any TP analysis run;
- The statute of limitations in Italy is 6 years, so it is very likely that the set of information (i.e. financial statements of comparable taxpayers) available to ITA at the time of the audit is much more extensive than that used by the taxpayer at the time of the analysis; and
- While ITA usually accepts the transfer pricing method selected by taxpayers who prepare the TP documentation, it very often adjusts the analysis performed by them, for example, by excluding some of the comparable taxpayers selected or adding new ones.

Advanced pricing agreements (APAs), dispute avoidance and resolution

With a view to preventing litigation, **Italian taxpayers have access to APAs** – though they are still not very widespread and are confined to large companies, because of the time required to reach an agreement and the complexity of the process.

APAs are binding for ITA for a total period of **five fiscal years**; the one in which the agreement is signed and the four subsequent years.

If, on the other hand, a taxpayer suffers a transfer pricing adjustment, a settlement with ITA can be reached. In this case, **penalties are reduced to 1/3 of the minimum** unless penalty protection is applicable.

Moreover, the Italian government recently introduced **a simplified procedure for the recognition of correlative adjustments, which gives Italian taxpayers the opportunity to reduce their taxable income** where, for example, a foreign related party suffers a transfer pricing adjustment relating to a transaction in which an Italian taxpayer is the counterparty. The latter may ask ITA, under certain conditions, to reduce its taxable income, mirroring the adjustment suffered by the foreign related party.

The simplified procedure will lead to an agreement within a relatively short period of time (180 days).

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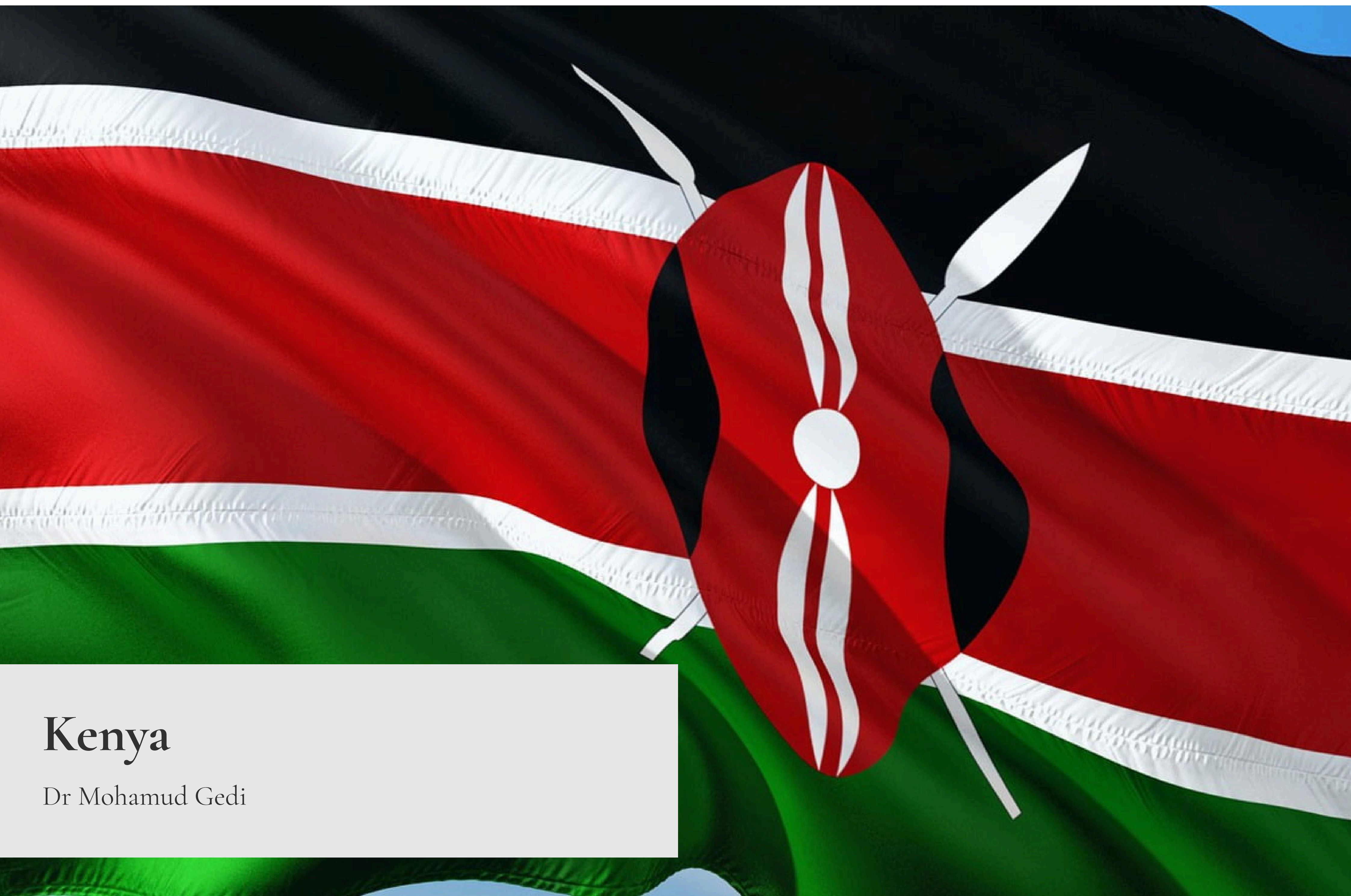

Kenya

Dr Mohamud Gedi

KENYA

by Dr Mohamud Gedi

Dr Mohamud Gedi is managing partner of Geal and Associates LLP, a CPA firm based in Nairobi, Kenya. He has nineteen years of experience in audit, tax and advisory. He has been instrumental in expansion of the firm in East African Countries with corporate clients in Kenya, Somalia, South Sudan as well as Ethiopia. **Contact Mohamud**.

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The Kenyan Income Tax Act (ITA) empowers the Commissioner of the Kenya Revenue Authority (KRA) to adjust the profits accruing to a resident company from any business conducted with non-resident related persons to reflect such profits as would otherwise have been made by independent persons dealing at arm's length.

The ITA defines "related persons" as persons who participate either directly or indirectly in the management, control, or capital of the business of the other; a third person who participates directly or indirectly in the management, control, or capital of the business of both; or an individual who participates in the management, control, or capital of the business of an "other", associated by marriage, consanguinity, or affinity to an individual who participates in the management, control, or capital of the business of the other.

The ITA also empowers the KRA to adjust profits accruing from resident persons conducting business with related resident persons operating in a Preferential Tax Regime (PTR), or a resident person conducting business with a non-resident person, an associated enterprise of a non-resident person, or a permanent establishment of a non-resident person located in a PTR.

A PTR has been defined as any Kenyan legislation, regulation, or administrative practice which provides a preferential

rate of tax to such income/profit, including reductions in the tax rate and the tax base or a foreign jurisdiction, that lack transparency on corporate and financial information exchange protocols.

In 2006, the minister in charge of the national treasury issued the guidelines that determine the arm's length value of related party transactions, also known as the Income Tax (Transfer Pricing Rules) in 2006. These rules borrow heavily from the OECD guidelines.

Transfer pricing in Kenya applies to the following transactions: i) the sale or purchase of goods and services; ii) the sale, use, purchase, or lease of tangible and intangible assets; and iii) the lending or borrowing of money and any other transactions which may affect the profit or loss of a company. The KRA may request necessary information and documents for review where a taxpayer claims the use of transfer pricing rules in Kenya.

TP regulations in Kenya require that the arm's length standard be properly documented in a transfer pricing policy, and evidence of how the arm's length standard has been applied must made available to the KRA upon request.

Transfer pricing methods

The comparable uncontrolled price (CUP) method compares the transfer price in a controlled transaction with prices in an uncontrolled transaction, and provides that an accurate adjustment should be made to eliminate material price differences.

The resale price method (RPM) compares the resale price of the product with the resale price at which the product would be sold to an independent enterprise, provided that, in the application of this method, the resale price would be reduced by the resale price margin (the profit margin indicated by the reseller).

The cost plus method (CPM) assesses the cost incurred by the supplier of a product in a controlled transaction, with a markup added to make an appropriate profit in light of the functions performed, the assets used, and risks assumed by the supplier.

GEAL and Associates LLP is a registered accounting firm in Kenya, serving clients in government, commercial, manufacturing, and financial sectors. The firm specialises in accountancy, audit, and taxation services to small, medium, and large enterprises in Kenya and other east African countries.

The profit split method (PSM) juxtaposes how the profits earned in very closely interrelated controlled transactions are split among the related enterprises, depending on the functions performed by each enterprise in relation to the transaction, and compared with a profit split among independent enterprises in a joint venture.

The transactional net margin method (TNMM) analyses the net profit margin attained by a multinational enterprise in a controlled transaction compared to the net profit margin that would have been earned in comparable transactions by an independent enterprise.

The KRA also may prescribe the use of any other method where the above methods are ascertained to be unreliable in determining the arm's length price.

OECD guidelines

Kenya has embraced the OECD Transfer Pricing Guidelines and the OECD Base Erosion and Profit Shifting (BEPS) project outcomes as internationally recognised best practices to provide supplementary transfer pricing documentation guidelines.

Reporting requirements

The ITA requires constituent entities of a multinational group (whether the ultimate parent entity is in Kenya or not) that has an overall group turnover of KES 95 billion or more to comply with the three-tiered approach to transfer pricing documentation.

Reports to be provided to the Kenyan revenue authority to include filing a country-by-country reporting (CbCR) notification, preparing and filing a local file and master file on or before the end of the sixth month following the entity's financial year end, and a CbCR on or before the last day of the twelfth month following the group's year end.

Transfer pricing documentation in Kenya

Transfer pricing documentation in Kenya largely adopts the documentation approach outlined in the OECD Transfer Pricing Guidelines. This includes the selection of the TP method and the reasons for the selection; the application of the method, and factors considered; the organisational structure of the group; and details of the controlled transaction and economic assumptions, strategies, and policies applied in selecting the method.

Master file and local file documentation in Kenya

The master file contains a detailed overview of the group, a description of the supply chain, the group's research and development policy, a description of each constituent entity's contribution to value creation, financing activities, information about intangible assets, and the group's intercompany agreements. The local file contains information on the resident constituent

entity's activities within the multinational enterprise group, the management structure of the resident constituent entity, business strategies including structuring, description of the material-controlled transactions, and the resident constituent entity's business and competitive environment.

The Country-by-Country Report (CbCR)

The CbCR contains information relating to the identity of each constituent entity, its jurisdiction of tax residence, the nature of the main business activity, group's financial information including information relating to the amount of revenue, profit or loss before income tax, income tax paid, income tax accrued, stated capital and accumulated earnings.

Penalties

There are no specific penalties prescribed for failing to file TP documentation in Kenya. However, non-compliance with CbCR attracts a fine not exceeding KES 1 million, a prison term not exceeding 3 years, or both, upon conviction.

Economic analysis and how to demonstrate an arm's length result

Economic analysis involves searching and selecting comparable transactions or companies, considering the quality of data, assumptions and comparability factors, and selection of the appropriate economic and statistical data related to a transaction.

Advanced pricing agreements (APAs), dispute avoidance and resolution

There are no APAs in Kenya, however, the law allows taxpayers to seek a private ruling with respect to transactions needing clarification. Mutual Agreement Procedure (MAP) is available in Kenya to resident taxpayers for dispute resolution. Additionally, a strong independent judiciary provides amicable dispute settlement for transfer pricing.

Mexico

Prof José Carreras

MEXICO

by **Prof José Carreras Benitez**

José Carreras is the tax partner in charge of dealing with international businesses. Since the year 2000, he has gained experience in offering value-added tax opinions, and win-win ideas. José is fluent in both Spanish and English.

I. Introduction and brief overview

Transfer pricing rules

In general, transfer pricing regulations in Mexico are provided in **Article 76, Sections IX, X, and XII of the Income Tax Law** (also known as **LISR**, its Spanish acronym), which establishes the obligation for legal entities to obtain and keep the documentation that proves that transactions carried out with foreign and domestic related parties generating taxable income or authorised deductions for income tax purposes are at market value. An exception to such compliance is available for certain taxpayers with lower incomes.

Transfer pricing methods

The basic methods for establishing transfer prices in Mexico are as follows:

1. Comparable uncontrolled price method
2. Resale price method
3. Cost plus method
4. Profit sharing method
5. Residual profit split method
6. Transactional operating profit margin method

Under Mexican law, the method of profit sharing established in the OECD TP guidelines (TPGs) is divided into two separate methods.

OECD guidance

The OECD TPGs are referenced explicitly in the Mexican legislation and are used for guidance and interpretation in transfer pricing-related issues.

Regarding corporations, and for income tax purposes, two or more persons are considered to be related parties when one of them participates, directly or

indirectly, in the administration, control, or equity of the other or when a person or group of persons participates, directly or indirectly, in the administration, control, or equity of such persons.

Reporting requirements in Mexico

The informative report on transactions with related parties with foreign tax residence (Annex 9 DIM). The information sought in this report includes identification data of each of the related parties; the types and number of transactions carried out with each related party; the transfer pricing methodology applied for each transaction, including the ranges of values determined when comparables have been used.

Additionally, this report requests data related to the results of the transfer pricing study, the adjustments applied during the tax year, and an indication whether the transfer pricing study is available. This statement must be filed no later than May 15 of the following tax year.

New BEPS informative reports. LISR requires taxpayers that enter into transactions with related parties with foreign tax residences to provide the tax authorities (no later than 31 December of the year immediately following the tax year in question) with the following related party reports:

1. Multinational business group related party master informative report;
2. Local related party informative report; and
3. Country-by-country informative report of the multinational business group.

II. Transfer pricing documentation in Mexico

Preparation of transfer pricing documentation

Article 76, section IX of the Income Tax Law (LISR) sets forth the information required to be recorded and disclosed in a transfer pricing study as follows:

1. The name, corporate name, domicile, and tax residence of the related parties with whom transactions are carried out, as well as documentation that proves the direct and indirect participation of the related parties;
2. Information related to the functions or activities, assets used, and risks the taxpayer assumes for each type of operation;
3. Information and documentation on transactions with related parties and the amounts for each related party and each type of transaction under the classification and data established in Article 179 of the Income Tax Law; and
4. The method applied following Article 180 of the Income Tax Law, including information and documentation on comparable transactions or companies for each type of transaction.

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Master and Mexico local file

The **local file** aims to provide specific information on intercompany transactions carried out by the taxpayer, perfectly detailing and identifying the parties involved, describing the generalities of the transactions carried out, and, with a robust analysis of the comparability criteria and applicable analysis methodology, concluding and demonstrating full compliance with the TP standard. The local report is basically the traditional transfer pricing study.

The **master file** is intended to provide a comprehensive and generalised overview of the structure and operating dynamics of the corporate group as a whole in terms of its intercompany interactions. This report analyses the group's operations, financing policies, its policy for the development, use, and exploitation of intangibles, and the group's internal services policy.

Finally, the country-by-country report (**CbCR**) is a standard form to be completed and submitted by the multinational group to provide annual, integrated information on the economic activities carried out by each entity that is part of the group, and in each tax jurisdiction. It is a more financial than descriptive document compared to the first two reports.

Penalties

The penalties for non-compliance with TP rules are as follows:

1. Failure to file an Annex 9 DIM is subject to a fine of between MXN 86,050 and MXN 172,100.
2. Failure to send the informative annual reports of operations with related parties (local, master, and CbCR) will result in fines from MXN 172,480 to MXN 245,570. Also, the taxpayer will not be able to carry out procurement, leasing, services, or public works contracts with the Federal Public Administration, both

centralised and parastatal, or with the Federal Attorney General's Office (Article 32-D Section IV of the CFF). Likewise, the taxpayer will be suspended from the importers' registry if they have not filed the federal tax returns required by law.

3. Digital seal certificates (those used for issuing electronic invoices) may be temporarily restricted when there is a:

- Failure to file the informative report (Annex 9) of the DIM for transactions with related parties;
- Failure to identify related party transactions in the accounting records; or
- Failure to carry out accounting (the Transfer Pricing Study is part of the accounting), among other restrictions.

Economic analysis and how to demonstrate an arm's length result

Economic analysis is regulated in Section IX of Article 76 of the Income Tax Law, which establishes the minimum elements that the TP analysis must contain. This section refers us to the methodology established in Article 180 of the same law.

To demonstrate compliance with the arm's length principle, the established methodology (one of the 6 methods used in Mexico) must be applied for each transaction.

In Mexico, unlike other countries and the OECD, there is a hierarchy of methods whereby you may directly apply the method that best demonstrates compliance with the arm's length principle.

The CUP method should be applied in the first instance, giving preference to the RPM and CPM; only when its application is not possible may one of the other methods be used.

Advanced pricing agreements (APAs), dispute avoidance and resolution.

Mexico currently allows the APA as a valid transfer pricing method to determine compliance with the arm's length principle as an alternative to the transfer pricing study.

Contract manufacturing companies, better known as limited risk manufacturing companies within the IMMEX* programme, are not allowed to process an APA or perform a transfer pricing study to determine compliance. This is only allowed through a safe harbour, which consists of determining a profit for tax purposes, and considering elements such as the value of the assets or the costs and expenses incurred.

*IMMEX stands for Industria Manufacturera, Maquiladora y de Servicios de Exportacion (Manufacturing, Maquiladora and Export Services Industry).

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The Netherlands

Camiel Lokkerbol and Parham Rahim Zadeh

THE NETHERLANDS

by **Camiel Lokkerbol** and **Parham Rahim Zadeh**

Camiel Lokkerbol is the Dutch Tax Partner leading the international tax practice at JAN©, serving clients ranging from high-net-worth individuals to MNEs. Camiel has more than 23 years of experience as a tax advisor in both local Dutch tax regulation and international tax implications and disputes. **Contact Camiel**.

In our globalised world with a heavy multinational corporation presence, transfer pricing regulations ensure tax obligations are equitably distributed. The Netherlands recently marked the one-year anniversary of its updated transfer pricing decree (Verrekenprijsbesluit 2022) issued on 01 July 2022, which reevaluated and updated their stance on the arm's-length principle, replacing the earlier decree from 11 May 2018. Notably, Article 8bd Corporate Income Tax Act (CITA), effective since 01 January 2022, addresses intercompany transaction mismatches, highlighting the Dutch government's dedication to curbing tax evasion and promoting tax fairness.

Transfer Pricing Rules

The at arm's length principle is laid down in Art. 9 OECD Model Convention. There are agreements within the OECD member countries on the application of the at arm's length principle with respect to cross-border transactions. These agreements apply directly to Dutch tax law when determining the total profit of a taxpayer pursuant to Art. 3.8 of the Income Tax Act 2001 in conjunction with Art. 8 Dutch Corporate Income Tax Act (CITA). The codification of article 9 OECD has been codified in article 8b CITA. This codification confirms that the at arm's length principle as laid down in art. 9 OECD Model Convention is applicable in the Netherlands.

Transfer Pricing Methods

This new decree reemphasizes

the importance of various globally recognized transfer pricing methods. These include the Comparable Uncontrolled Price (CUP) method, the Resale Price method, the Cost Plus method, the Transactional Net Margin method, and the Transactional Profit Split method. Each of these methods offers a unique approach to calculating appropriate transfer prices, depending on the nature of the transactions and the availability of comparable data.

OECD Guidance

The new decree underscores the relevance of the OECD Guidelines in interpreting and clarifying the arm's-length principle. The Dutch Finance Secretary has stressed the alignment of the decree with changes in the OECD Guidelines, pointing out that these changes apply even to years in which they were not yet published and therefore can be applied to pricing of intercompany transactions that were established before the introduction of the new decree, thereby emphasizing the retrospective effect of such clarifications. Please note that there are differing opinions about the retroactive effect, as the decree should only be seen as an interpretation and not as law[1].

Reporting requirements

The rules for mandatory Transfer Pricing documentation (Local File and Master File) are activated once a group that has cross-border transactions with related companies has a consolidated group revenue of over €50 million annually.

There is also a obligation for group companies in The Netherlands to document their transfer pricing policy in form free documentation when they have a consolidated group revenue of less than €50 million annually. This applies both for national and cross border transactions with related companies.

For larger groups a Country by Country Reporting (CbCr) obligation also is obliged when the consolidated group revenue exceeds €750 million annually.

Preparation of transfer pricing documentation

Groups with different annual consolidated revenues must

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adhere to specific documentation types:

1. Groups under €50 million revenue require form-free documentation for local and cross-border transactions. As per Art. 8b, paragraph 3 CITA, this should detail:

- Transfer pricing determination;
- Compliance with conditions expected between independent parties. This documentation should be ready when the transaction occurs.

2. Groups over €50 million revenue need:

- A Local File for all cross-border transactions, available before the respective CIT return is filed;
- A Master File giving a group overview, prepared before the CIT return for that year.

3. For groups over €750 million revenue, a CbCr obligation must be prepared in Dutch format, notified by the last day of the reporting year.

Master and Local File

The decree, while not detailing specific requirements for the Master and Local file, insists on the importance of consistency with the OECD guidelines. These documents should provide a complete overview of the multinational enterprise's global business operations and transfer pricing policies.

Penalties

The decree doesn't specify penalties for non-compliance, but it's crucial for taxpayers to adhere to the regulations. Non-compliance could lead to disputes with the Dutch Tax Authorities (DTA) and potential hefty penalties.

Economic analysis and Demonstrating Arm's Length Results

In terms of economic analysis, the decree underscores the importance of taking into account the economically significant factors and analysing the functional and risk profile of the companies involved in a transaction. It is crucial that each party in a transaction receives an arm's-length reward for its control function, particularly in situations where multiple parties exercise control over a risk.

Before the price of a particular transaction between related parties can be determined, the transaction must be characterized as such. This requires an analysis of the economically relevant characteristics of the

JAN© is an all-round accountancy, law, and tax firm, serving Dutch and international clients. With over 150 employees JAN© helps their clients with projects from filing personal Inco tax Returns, to (international) mergers and acquisitions, and to compiling their transfer pricing documentation.

transaction.

The starting point in characterizing the transaction, prior to the application of the arm's-length principle, is the transaction as designed between the related parties with contractual terms in the agreement(s) between them, supplemented, if necessary, by information from other records about the mutual rights and obligations.

This information should then be supplemented by an analysis of the other economically relevant features of the transaction. All this information together provides insight into the actual behavior of the parties involved. If the actual behavior does not correspond to the contractual design of the transaction, overall the actual behavior will determine the characterization of the transaction.

Advanced Pricing Agreements

As a proactive measure to avoid potential conflicts with tax authorities, the decree confirms the possibility for taxpayers to obtain advance certainty on their transfer pricing positions in the Netherlands through Advanced Pricing Agreements (APAs), , in which an APA can only be given if the company requesting the APA has sufficient economic nexus according to Dutch standards. The requirements, as outlined in the ruling decree dated 9 August 2021 (nr. 2021 – 16465), [2] are relevant in this regard.

Conclusion

In summary, the newly published decree and the enactment of Article 8bd CITA provide an updated and comprehensive framework for transfer pricing in the Netherlands. These changes are a testament to the Dutch government's commitment to aligning its domestic tax laws with international norms, thereby promoting a more transparent, fair, and robust tax environment. However, the practical implications of these changes will likely unfold in the coming years as taxpayers and the Dutch Tax Administration navigate the nuances of these new guidelines. Therefore we are more then happy to assist you in these complex matters.

[1] https://new.navigator.nl/document/id858e969ed1004a0aba3b0468e

[2] https://zoek.officielebekendmaki stcrt-2021-38442.html

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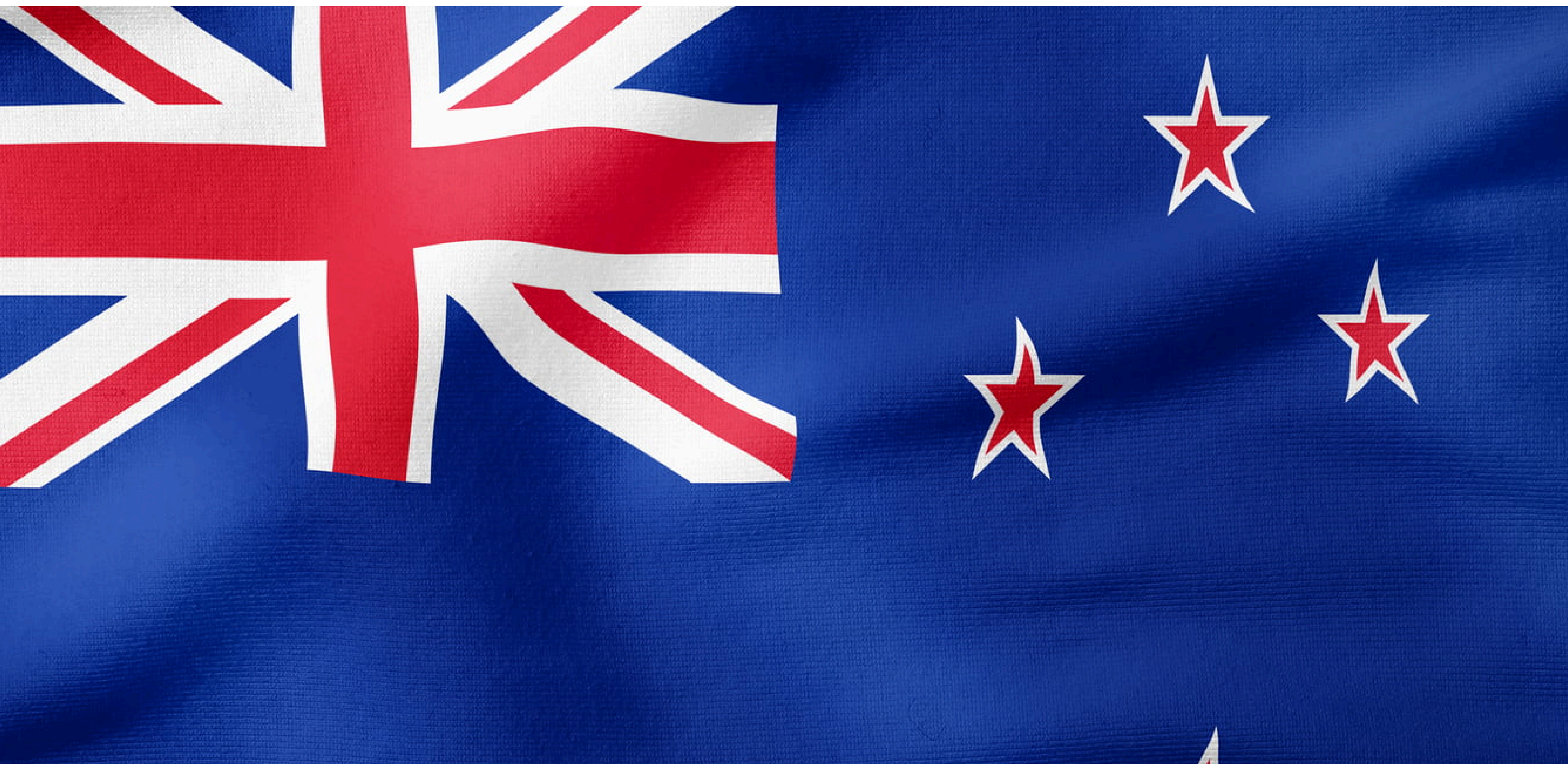

New Zealand

Stephen Rutherford

NEW ZEALAND

by Stephen Rutherford

The New Zealand transfer pricing regime applies to cross-border, related-party transactions. This includes transactions between associated persons, transactions with members of a non-resident owning body (e.g., those who 'act together' to control the New Zealand taxpayer), and cross-border, related-party borrowings.

The New Zealand transfer pricing rules are applied consistently with the OECD transfer pricing guidelines and require taxpayers to treat all cross-border transactions with associates as having been made for an arm's-length consideration. One notable exception is the restricted transfer pricing rule, which applies to inbound debt in excess of NZD 10 million (as discussed below).

The transfer pricing rules apply to arrangements for the acquisition or supply of goods, services, money, intangible property, and anything else (other than non-fixed rate shares or capital transactions) where the supplier and acquirer are associated persons.

Transfer Pricing Methods

There are various methods that are appropriate for determining the 'arm's-length consideration' as defined by the OECD guidelines. The parties are required to use the method that produces the most reliable measure of the amount that independent parties would have paid or received in respect of the same or similar transactions when operating in a commercially rational manner

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by using one or more of the five permitted transfer pricing methods, being:

- The comparable uncontrolled price method
- The resale price method
- The cost-plus method
- The transactional profit split method, or
- The transactional net margin method.

The arm's length amount of consideration is to be ascertained considering the arm's length conditions for the transaction. The legal form of the parties' agreement may be reconstructed or disregarded if it is commercially irrational and would not have been entered into by parties acting on an arm's length basis.

Advanced Pricing Agreements: (APAs)

Advanced pricing agreements (APAs) are extremely useful as a robust upfront means of dealing with transfer pricing risk, especially the more complex issues that arise.

The NZ IRD sees APAs as co-operative approaches that encourage up-front compliance and early resolution of potential disputes.

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Documentation

While there is no current regulatory requirement to maintain transfer pricing documentation in New Zealand, the New Zealand Inland Revenue has published guidelines that make it clear that documentation is required to support a taxpayer's transfer prices. The New Zealand tax system operates on a self-assessment basis, where taxpayers are expected to keep sufficient records to support their tax position. The onus of proof has shifted to the taxpayer, a move that increase the importance of keeping proper documentation.

New Zealand will accept that documentation prepared in accordance with OECD guideline and have not

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imposed any additional requirements. [The New Zealand IRD considers it is local management's responsibility to maintain transfer pricing documents.]

New Zealand transfer pricing rules have a range of simplification measures targeting intra-group services (where cost plus 5% without the need for bench-markup), small loans and for wholesale distribution markups.

Master File and Local Files

New Zealand endorses the OECD approach to transfer pricing documentation and accepts local file and master file documentation prepared in accordance with this approach. In the interests of containing compliance costs, the IRD has not implemented specific rules for the maintenance or filing of local file and master file documentation.

The OECD's Master File and Local File concept is regarded as best practice. In addition, for larger groups (over EUR750m) NZ has implemented CbCR (Country by Country Reporting).

Inward Bound Debt

New Zealand has enacted a restricted transfer pricing (RTP) rule that applies to inbound debt in excess of NZD 10 million. The RTP rule contains a prescriptive set of rules and criteria and moves away from traditional arm's-length principles. The rule effectively requires debt to be priced as plain vanilla senior debt with a rebuttable presumption of parental support unless the foreign parent has substantial third-party debt that includes different terms.

In addition, New Zealand has implemented (BEPS) rules in accordance with the OECD 16 20 BEPS project that require specific documentation for multinational entities, in contrast with New Zealand's thin capitalisation rules. Country by country (CBC) reporting requirements apply to groups headquartered in New Zealand with annual consolidated ground reviews over EUR 750 million.

Risk and Risk Areas

The New Zealand IRD considers transfer pricing to be one of the most important issues arising in international tax and therefore actively focuses on this area. Audits or investigations may be performed specifically for transfer pricing issues, or alternatively combined with normal tax audits. The IRD has published the following risk factors that they consider could give rise to transfer pricing enquires.

- Significant enterprises that target smaller subsidiary companies under the ownership of prominent multinational corporations. The Inland Revenue is likely to do an analysis of basic compliance packages (financial statements, tax reconciliations, and corporate structures) supplemented by questionnaires.
- Unexplained tax losses returned by foreign-owned

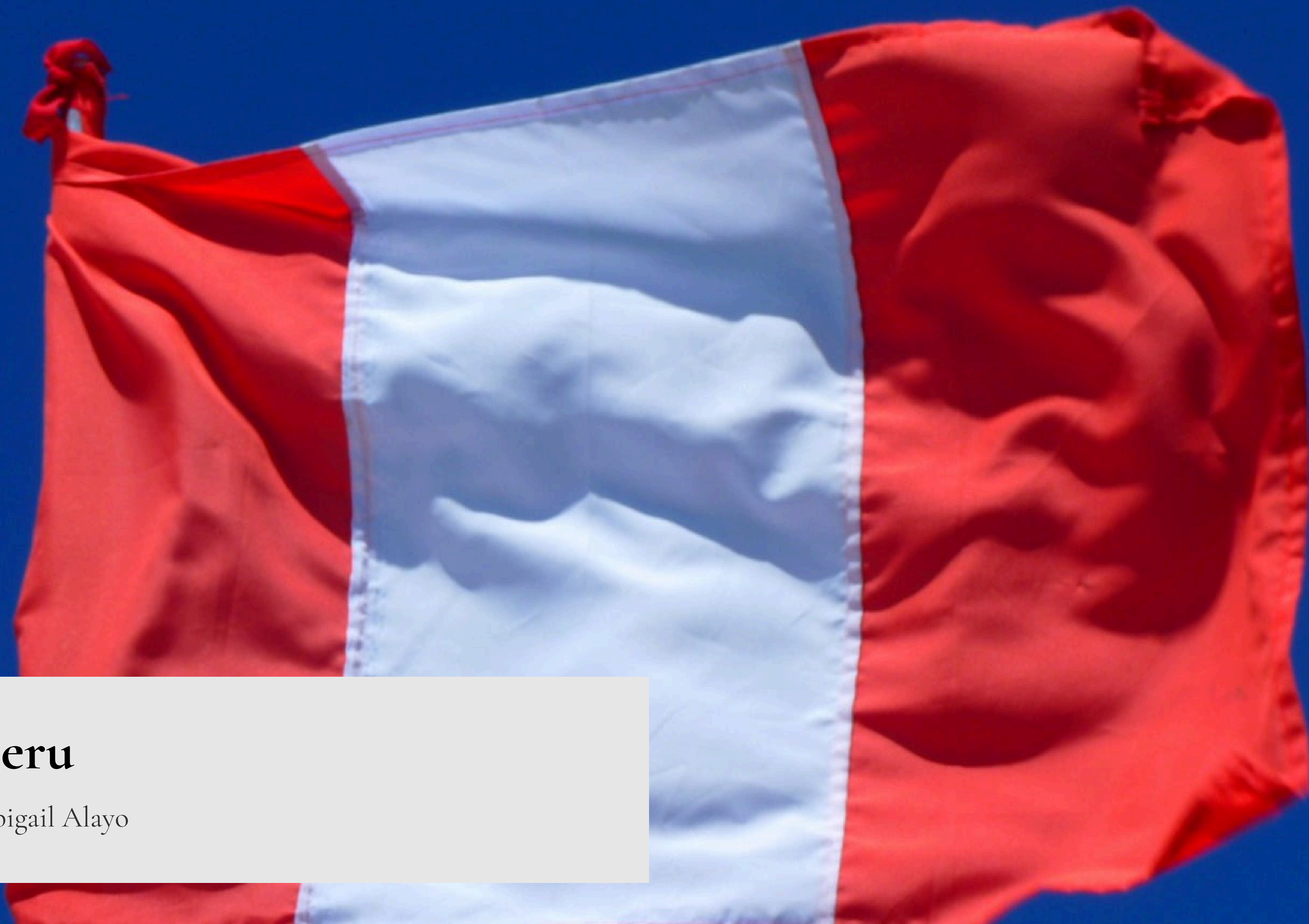
groups (two consecutive years of tax losses).

- Loans in excess of NZD 10 million principle and guarantee fees.
- Material associated party transactions with no or low tax jurisdictions.
- Supply chain restructures involving the shifting of any major functions, assets or risks away from NZ.
- Any unusual arrangements or outcomes that may be identified in controlled foreign company disclosures.

Penalties

Specified penalties may be applied in addition to adjustments arising from transfer pricing issues and can range from 20% up to 150% of the tax shortfall. Determination of the penalties focuses on culpability and can also reflect the level of co-operation by the taxpayer. Interest will also be charged on any tax shortfall.

In conclusion, New Zealand transfer pricing rules are expected to be consistent with the OECD guidelines and have appropriate documentation compatible with the level of economic activity in New Zealand and transfer pricing risk associated with that activity.



Peru

Abigail Alayo

PERU

by **Abigail Alayo**

Abigail Alayo is a Tax & Legal Partner with VAG Global. She's a Certified Public Accountant and Administrator graduated from the Universidad Peruana de Ciencias Aplicadas with Postgraduate in Corporate Finance, Tax Law, Business Taxation and Postgraduate Specialised in Prices of Transfer by CIAT. Experience of more than 10 years in the area of accounting, taxation and legal.

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Formal transfer pricing obligations in Peru

The OECD Transfer Pricing Guidelines have become a fundamental reference for many countries in designing their tax regulations in this field. In Peru, the adoption of these guidelines represents an effort to align with international standards and ensure transparency and fairness in transactions between related companies. The National Superintendence of Customs and Tax Administration (SUNAT) is the entity responsible for implementing and overseeing these regulations.

The adoption of the OECD Transfer Pricing Guidelines in Peru has had several significant implications. While it is true that this adoption strengthens Peru's position in the international community by demonstrating its commitment to best practices in tax matters and its willingness to prevent erosion of the tax base and profit shifting, it has also allowed tax authorities in Peru to establish more effective mechanisms to detect and prevent transfer pricing practices that do not comply with market conditions. This has led to increased rigor in audits and reviews of transactions between related companies.

In recent years, transfer pricing (TP) has become an increasing focus in Peru. Regulations have been implemented gradually, year after year, with several information affidavits currently in effect, which apply to taxpayers subject to the TP regime; these include the local report, master file, and country-by-country report (CbCR). In addition, there has been an increase in transfer pricing adjustments in related-party transactions during the auditing process.

Transfer pricing obligations are regulated under the provisions of Legislative Decree No. 1312 and Superintendency Resolution No. 163-2018/ SUNAT. According to these provisions, binding conditions have been established for filing the local report, the master file, and the CbCR under the current TP regime. The criteria to be considered by taxpayers to determine their obligation in each fiscal year are detailed below.

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Local report

Taxpayers are obliged to file the Information Affidavit – Local Report, which is divided into two sections, to be completed as follow:

Section I:

When the accrued income has exceeded PEN 11.385 million (i.e. 2,300 tax units[1]) in the previous fiscal year and the taxpayer has had transactions within the application scope of transfer pricing for an amount equal to or greater than PEN 495,000 (100 tax units) and less than PEN 1.98 million (400 tax units).

Section II:

When the accrued income has exceeded PEN 11.385 million (2,300 tax units) in the previous fiscal year and the taxpayer has had transactions within the application scope of transfer pricing for an amount equal to or greater than PEN 1.98 million (400 tax units).

Master file

The Information Affidavit – Master File must be filed by taxpayers and members of multinational groups (as defined by the income tax law regulations) who meet the following conditions:

1. Whose accrued income has exceeded PEN 99 million (20,000 tax units).
2. Having carried out transactions within the application scope of the transfer pricing rules, where the value of transactions is equal to or greater than PEN 1.98 million (400 tax units).

Country-by-country report

Taxpayers who form part of a multinational group with a consolidated income of PEN 2.7 billion or more for the year under analysis must file a statement for the following parties:

1. The parent company of the multinational group, domiciled in the country.
2. The taxpayer

domiciled in the country belonging to the multinational group when, even the parent company is not domiciled in Peru, any of the following situations are verified:

- The taxpayer would have been appointed by the group as the parent company representative.
- One or more of the conditions set forth in paragraphs 1 to 3 of subsection b) of Article 116 of the Income Tax Law Regulations are met.

If there are several taxpayers in the group that are domiciled in the country, the person in charge of filing the statement will be the one designated by the group.

It should be noted that the taxpayer obliged to file the statement must communicate their appointment to the Peruvian government tax administration (SUNAT) by the last working day of the month prior to the reporting month. If the filing is not submitted, all member taxpayers of the multinational group domiciled in the country will be considered responsible.

Likewise, the taxpayer listed in one or more of the conditions set forth in paragraphs 1 to 3 of subsection b) of Article 116 of the Income Tax Law regulations will be exempt from filing the CbCR if, on or before the due date for its filing, the multinational group files the statement through a parent company representative domiciled or resident in another jurisdiction, according to the provisions of the penultimate paragraph of the aforementioned subsection.

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Therefore, the taxpayer domiciled in the country must communicate to SUNAT the designation of the parent representative domiciled or resident in another jurisdiction through a written document signed by their legal representative, attaching a simple copy of the communication filed by the parent representative in the jurisdiction of its domicile or residence. The communication must be filed at the office in charge of receiving their paid statements until the expiration of the deadline for filing the statement.

Profit test

Finally, subsection i) of Article 32-A of the Income Tax Law establishes that the services received by the taxpayer from related parties must comply with the “profit test” for the deduction of costs and expenses to determine Income Tax.

In order to comply with the profit test, the following must be evaluated, verified, and adequately supported:

- The rendered service effectively provide economic and/or commercial value for the taxpayer;
- The services under analysis qualify as high or low added value;
- The profit margin of low value-added services does not exceed 5%.
- Documentation and supporting information evidencing the effective rendering, nature, and necessity of the services; the costs and expenses incurred by the provider; and the profit margin.

The Peru tax administration is increasingly focused on the issue of transfer pricing, and has increased the number of audits carried out in this area. It is critical to stay up informed about current and updated regulations, and to have a good consultant to ensure proper compliance with TP filing obligations.

Penalties

The penalties for non-compliance with the filing of informational sworn statements are established in sections 2 and 4 of article 176 of the Tax Code of Peru.

If they are not filed within the established deadlines or are submitted incompletely, the penalty will amount to 0.6% of net income, with a cap of 25 UIT (Tax Units). The taxpayer can opt for the gradual compliance regime when an error occurred while submitting any of these reports, upon rectifying the error.

APAs

Since 2004, the Income Tax Law (IR) establishes the possibility for taxpayers to enter into an Advanced Price Agreement (APA) with SUNAT, which stands for 'Acuerdo Anticipado de Precios de Transferencia' in Spanish. In general terms, the APA aims to reduce disputes in transfer pricing matters; however, in Peru, no APA has been concluded to date.

The complexity and high cost of preparing the proposal, the excessive timelines for its evaluation, and the need to provide sensitive information about the involved parties, all contribute to making potential applicants think twice before deciding to propose an APA to SUNAT.

[1] For the fiscal year 2023, PEN 4,950.

Poland

Piotr Prokocki

POLAND

by Piotr Prokocki

Piotr specialises in comprehensive tax services for M&A, develops effective and tax-safe structures for financing transactions, capital withdrawal and profit distribution.
Contact Piotr.

Polish transfer pricing regulations are based on the **OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations**. When it comes to related entities, the arm's length principle requires transactions to be priced as if they were carried out between unrelated entities.

Definition of related entities

Polish transfer pricing regulations define related entities as those having a direct or indirect relationship that involves exerting **significant influence**. This can take any of the following forms:

1. Holding – directly or indirectly – at least **25%** of capital, voting rights, shares, or rights to participate in profits;
2. Having the actual ability to influence **key economic decisions** of a given entity; or
3. Being married or closely related.

Local file

Related entities are required to prepare local transfer pricing documentation known as a **local file**. This obligation applies to transactions of a **homogeneous nature** whose value in a given tax year amounts to at least:

1. **PLN 10 million** (approx. EUR 2.2 million) – in the case of commodity and financial transactions; or
2. **PLN 2 million** (approx. EUR 440,000) – in the case of service and other transactions.

Polish regulations allow for certain exemptions from the obligation to prepare local transfer pricing documentation. For example, if statutory conditions are met, loans and low-value-adding services may fall under the simplified "safe harbour" regime.

Transactions with tax havens

The obligation to prepare local transfer pricing documentation may also arise with respect to transactions with related and unrelated entities whose registered office, or management board, is based in

a tax haven. For such transactions, the documentation thresholds are as follows:

1. **PLN 2.5 million** (approx. EUR 550,000) – in the case of financial transactions;
2. **PLN 500,000** (approx. EUR 110,000) – in the case of other transactions.

Homogeneous transactions

The statutory documentation thresholds apply to transactions of a **homogeneous nature**. If a given entity has carried out several homogeneous transactions with different entities, their values should be summed up to see whether the total exceeds the applicable thresholds.

When assessing the nature of transactions, particular attention should be paid to their economic uniformity, transfer pricing verification methods, and transaction details. Examples of homogeneous transactions include providing the same service to several related entities or executing several loan agreements with the same related entity.

Calculating transaction value

The following should be taken into account when calculating the value of a transaction:

1. **Value of capital** – in the case of a loan or deposit;
2. **Nominal value** – in the case of issuing bonds;
3. **Guarantee amount** – in the case of a surety or guarantee;
4. **Value of revenues or costs** – in the case of income (loss) attributed to a foreign permanent establishment;
5. **Value of contributions** made to a partnership; and
6. **Appropriate value** – in the case of other transactions.

The value of the transaction should be determined based on the following:

1. **Invoices received** or issued for a given tax year;
2. **Contracts** or other documents (in the case of financial transactions); and
3. **Payments received** or transferred (where it is impossible to determine the value based on invoices, contracts, and other documents).

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Components of a local file

According to Polish regulations, local transfer pricing documentation must contain certain essential components. These include information about the related entity, transaction details, an analysis of functions, assets, and risks (FAR), and financial data about the transaction.

As of 2019, all local files must

also include a transfer pricing analysis, which may take the form of a benchmarking or compliance analysis (where a benchmarking analysis is not feasible).

Transfer pricing information

Entities required to prepare local transfer pricing documentation must also file transfer pricing information with the competent tax office.

The TPR-C form used for this purpose must provide details about related entities and controlled transactions, including the transfer pricing method used and the analysis results.

Effective 2022, the TPR-C form contains a statement to the effect that local transfer pricing documentation has been created and transfer prices have been established at arm's length. Previously, such statements had to be made separately. The TPR-C form may be signed by a designated member of the company's management board.

Master file

In some cases, in addition to preparing local documentation, related entities must also provide **group transfer pricing documentation** known as a master file.

This obligation applies to related entities forming a group which prepares consolidated financial statements, provided that their consolidated revenues in the previous financial year amounted to at least PLN 200 million (approx. EUR 44 million).

Deadlines

The deadline for preparing local transfer pricing documentation expires at the end of the **10th month** after the end of the tax year in which transactions with related entities were carried out. The deadline for providing the group documentation expires at the end of the **12th month** after the end of the tax year. Transfer pricing information (TPR-C) should be filed by the end of the **11th month** after the end of the tax year.

Sanctions

Polish regulations provide for various sanctions in case an entity fails to discharge its transfer pricing obligations:

1. **CIT arrears** – If the tax authorities conduct an inspection and find that a transfer price was not set at arm's length, the entity will have to pay overdue corporate income tax (CIT) with penalty interest;
2. **Additional tax liability** – The tax authorities may impose an additional tax liability amounting to 10% of the reported or overstated tax loss or understated income. If local transfer pricing documentation is not prepared, this sanction is doubled (up to 20% of the overstated loss or understated income), and may even be tripled in some cases;
3. **Fiscal criminal sanctions** –

Under the Fiscal Criminal Code, entities may face a fine of up to 720 daily rates (equivalent to over PLN 33 million) for failing to submit a TPR-C form, submitting a TPR-C form with inaccurate information, not preparing transfer pricing documentation, or preparing transfer pricing documentation that contains inaccurate data.

Advanced Pricing Agreements

The Polish provisions allow entities to enter into Advanced Pricing Agreements (APAs) with a Head of National Tax Administration. This is a type of agreement between the taxpayer and the tax authority in which the tax authority approves the selection and application of the transfer price verification method used between the taxpayer and its related parties. APAs can be in force for up to 5 years. APAs are an effective instrument to reduce the risk of incorrectly determined transfer prices and their questioning by the tax authorities.

Transactions below the threshold

Although Polish regulations set statutory thresholds for transactions between related entities that should be documented for tax purposes, the above sanctions may be imposed regardless of whether the annual value of transactions exceeds those thresholds. The key is to remember that **the arm's length principle applies to all transactions between related entities**, regardless of their annual value.

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Singapore

Eddie Lee

SINGAPORE

by **Eddie Lee**

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Introduction

Transfer Pricing ("TP") is an essential aspect of the regulatory requirements in Singapore for companies which have intra-group transactions or related party transactions ("RPTs") in Singapore and if they expand their businesses outside Singapore.

TP rules require that those RPTs are conducted at arm's length prices, which refers to prices that would be agreed upon by unrelated parties in similar situations.

Transfer Pricing Regulations and Practices

Please note that there are **two** major compliance requirements under the Income Tax Act.

a) Section 34D – Arm's Length Principle

- Under Section 34D, all Singapore businesses are required to adhere to the **arms' length basis** of pricing for its RPTs except for certain transactions for which exemptions apply. The exemptions are summarised separately under Exemption from TPD Preparation (page 4). This RPTs can be the **purchase of goods, provision of services, borrowing or lending of money, use or transfer of intangibles and etc** where the pricing should reflect the arm's length principle.
- In relation to the above, the arm's length principle is the international standard to guide the transfer pricing between related parties. All companies in Singapore which have RPTs must adopt the arm's length principle by charging the related party same as the third party.

b) Section 34F – Transfer Pricing Documentation

- Under Section 34F, all Singapore businesses have to prepare a **contemporaneous** (i.e. requiring real-time data) **Transfer Pricing Documentation ("TPD")** for

submission to IRAS if their annual revenue/turnover is **more than SGD 10 million** and they did not meet the annual exemption threshold for the specific RPTs.

- The TPD is a report to substantiate that all RPTs within a group of companies are finalised on arm's length basis, meaning that the prices or margins of these intercompany transactions are comparable to what would have been entered into between outside or unrelated parties.
- As long as the details in the TPD remain accurate, it should be refreshed once every three years.
- The TPD must be kept for at least 5 years from the end of the basis period in which the RPT took place.

c) Summary of major requirements for preparing TPD under Section 34F

Scope	TPD requirements
When it takes effect	From YA 2019
Who must prepare	Companies who derived gross revenue from their trade or business with more than SGD 10 million
What to prepare	The details are prescribed in the TPD Rules and in IRAS tax guidelines. Data/ Information should be prepared at entity and group level.
When to prepare	Not later than the filing due date of the tax return.
When to submit	Within 30 days from date of request by IRAS to submit the TPD to IRAS.
How long to retain TPD	... the end of the basis period in which the RPTs took place

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d) Exemption from TPD Preparation

In situations where the gross annual revenue from trade or business is consistently below SGD 10 million, an exemption from TPD is applicable. It is also applicable where the gross annual revenue from trade or business is NOT more than SGD 10 million for the period but where TPD was mandatory in the immediate two preceding basis periods.

List of Specific Transactions Qualifying for TPD Exemption	Value per annum (SGD)
Related party domestic transactions subject to the same Singapore tax rate	No limit
Related party domestic loan	No limit
Related party loan with indicative margin applied above base loan interest rates	Loan below SGD 15 million
Routine support services on which a 5% cost plus is applied	No limit
Related party transactions covered by an Advance Pricing Agreement with IRAS	No limit
Purchase of goods from a related party	Below SDG 15 million
Sale of goods to a related party	Below SGD 15 million
Loan by a related party	Below SGD 15 million

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IRAS Tax Guidelines

The primary objective of the IRAS guidelines serves to provide companies with an understanding of the TP laws and regulations which cover the following areas:

- Application of the arm's length principle when transacting with their related parties and for specific RPTs such as related party services and loans,
- Preparation and maintenance of contemporaneous TPD for submission to IRAS,
- Procedure and process for avoidance and resolution of TP disputes under the double taxation agreements ("DTA") between Singapore and treaty countries,
- Clarification on non-compliance with transfer pricing requirements, and
- Overview of transfer pricing compliance programme.

The Three-Steps Approach

IRAS recommends that taxpayers **adopt the Transfer Pricing Analysis** which is the 3-step approach to apply the arm's length principle in their related party transactions:

Step 1 – Comparability analysis
Step 2 – Choice of transfer pricing methods
Step 3 – Testing the arm's length results

Transfer Pricing Methods

1. Comparable Uncontrolled Price ("CUP") Method
2. Resale Price ("RP") Method
3. Cost-Plus ("CP") Method
4. Transactional Profit Split

("PS") Method
5. Transactional Net Margin Method ("TNMM")

IRAS Specific Guidance

IRAS provides specific guidance on certain RPT services such as the followings.

1. Provision of related party services
2. Strict Pass-Through Costs
3. Markup Price Other Than 5%
4. Routine Support Services (RSS)
5. Cost Pooling Arrangement (there is no markup in the cost pooling)
6. Related Party Loans
7. OECD 5% Markup

Advanced Pricing Agreements ("APAs")

APAs are agreements made in advance with IRAS and foreign tax authorities regarding the pricing of a RPT upon taxpayer's application relating to a specific time-period. Upon successful application, IRAS may grant exemption for the preparation of the TPD where the RPTs are covered by the APA. The successful applicant must keep relevant documents for the purpose of preparing the annual compliance report to demonstrate compliance with the terms the APA, with essential assumptions unchanged.

You can read a more detailed version of this article HERE.

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ROBERT YAM & CO PAC, with a history of more than 40 years, was established in Singapore on 01 July 1977 as a firm of Chartered Accountants and Certified Public Accountants. Apart from the core business of auditing & assurance, accounting, and tax services, the firm also undertakes other professional work such as general business consultancy and advisory, regulatory compliances, risks assessments, tax planning, company liquidation & audit investigation.

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South Africa

Jess du Preez

South Africa

by **Jess du Preez**

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Introduction

In South Africa, transfer pricing is a stated priority for the South African Revenue Service (SARS). Whilst the legislation surrounding transfer pricing is brief, effectively referring to the arm's length principle, the regulations and guidance are extensive and conform for the most part to international norms. SARS is in the process of revising interpretation notes and practice notes relating to transfer pricing aspects in order to provide additional guidance to taxpayers.

a) Transfer pricing rules

Section 31 of the South African Income Tax Act No. 58 of 1962 governs the application of transfer pricing rules in South Africa. This section is used together with Practice Note 7 to practically apply the arm's length principle to affected transactions. While South Africa is not a member of the OECD, Practice Note 7 recommends following OECD guidelines if specific guidance is required that is not found within South African legislation.

b) Transfer pricing methods

SARS accepts the methods prescribed by the OECD to the extent they are clearly substantiated by supporting evidence. The methods are: the comparable uncontrolled price (CUP) method, the resale price method (RP), the cost plus method (CP), the transactional net margin method (TNMM), and the profit split method (PS).

1. **Comparable uncontrolled price (CUP) method**
   OECD guidelines state that the comparable uncontrolled price method provides the best evidence of an arm's length price. When using the CUP method, the price of a tangible asset transferred in an intragroup transaction is compared to the price of the same or similar asset transferred in a comparable third party transaction.
2. **Resale price method (RP)**
   The RP method compares the gross profit margin realised by the distributor in connection with the intragroup transaction to the

gross margin realised by it or a similar distributor in a comparable third party transaction.

3. **Cost plus method (CP)**
   Using the cost plus method, an arm's length markup on the costs is determined either from the taxpayer's sales of the product or a similar product to third parties in comparable transactions, or from the markup realised by unrelated taxpayers in comparable transactions with third parties. The CP method compares the gross profit margin realised between intercompany transactions and third party transactions.
4. **Transactional net margin method (TNMM)**
   The transactional net margin method (TNMM) can be used to test prices charged for tangible assets, intangible assets and as compensation for related party services. The TNMM compares the net profit margin of a taxpayer arising from a non-arm's length transaction with the net profit margins realised by arm's length parties from similar transactions. As the TNMM relies on a comparison of net margins, a high standard of comparability must be met in order for the TNMM to produce a reasonable estimate of an arm's length result.
5. **Profit split method (PS)**
   The profit split method may be applied where the operations of two or more non-arm's length parties are highly integrated, making it difficult to evaluate their transactions on an individual basis, and, therefore, preventing the application of the traditional transaction methods. Where the profit split method is applied, a detailed analysis of the functions performed by the parties to the transactions

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should be completed and well documented.

c) OCED guidance

As previously mentioned, South Africa is not a member of the OECD. However, Practice Note 7 acknowledges that the OECD guidelines should be followed in the absence of specific guidance in terms of PN7, Section 31, or the double taxation treaties to which South Africa is a party.

d) Reporting requirements

There is no specific transfer pricing return that needs to be submitted to SARS, however the SARS ITR14 corporate income tax return allows for customisation by way of a questionnaire that helps create a return tailored to a company's factual declarations. This includes questions relevant to the application of transfer pricing rules.

The ITR14, Master File, Local File and CbCR are all due 12 months after the company's financial year end. Therefore, it is recommended to submit the transfer pricing document to SARS together with the company's tax ITR14 tax return.

Transfer pricing documentation

Transfer pricing documentation should be prepared annually in English, with the related benchmarking studies which only need to be updated every 3 years. It is recommended that benchmarking studies be performed on transactions that exceed ZAR 5 million. SARS may request documentation substantiating the transfer pricing applied to transactions exceeding ZAR 5 million.

A local file and a master file are required by law to be prepared and filed if a company's affected transactions exceed or are expected to exceed ZAR 100 million in aggregate.

Country-by-country reporting (CbCR) is required if the consolidated group revenue exceeds ZAR 10 billion during the financial year immediately prior to the current financial year.

The non-submission of a company's tax return and related documents can result in administrative penalties levied by SARS. Penalties range between ZAR 250 and ZAR 16 000, depending on the taxpayer's taxable income from the preceding year. These penalties are charged on a monthly basis, per return outstanding, until the non-compliance is remedied.

In the event that SARS must make adjustments to the taxpayer's submission, an understatement penalty may be levied as a result of default, omission, incorrect disclosure, or misrepresentation. The penalty is calculated as a percentage of the shortfall arising from the understatement. Depending on the case, SARS can apply a percentage that ranges from 10% to 200% of the calculation.

Taxpayers may request a remission of the penalties, as long as they meet the

requirements of section 217 and 218 of the Tax Administration Act (TAA). Interest will be charged at the prescribed rate in conjunction with the penalties, however it is not possible to request remission of the interest charged.

Economic analysis and how to demonstrate an arm's length result

Economic analysis is an important step in the transfer pricing methodology. It is used to avoid base erosion and double taxation, in addition to supporting the application of the arm's length principle. The analysis involves profiling the various aspects that make up a company to select the most appropriate transfer pricing method to apply to its affected transactions.

Comparable transactions are identified by way of a benchmarking study. The benchmarking study finds comparable transactions from companies within the same industry to find a median against which the company's transactions can be assessed in order to determine whether they are at arm's length.

Advanced pricing agreements (APAs), dispute avoidance and resolution

There is currently no APA system in operation in South Africa. An APA is an agreement that determines a taxpayer's transfer pricing methodology for the pricing of their cross-border, related-party transactions in advance. This agreement is between a taxpayer and SARS to help mitigate the possibility of transfer pricing disputes.

On 11 November 2020, SARS published draft legislation and proposed a model for the establishment of an APA programme in South Africa. In addition to the draft legislation, SARS also released a discussion paper addressing the various considerations around BEPS and the implementation of APAs in South Africa, and which acknowledges that South Africa is lagging behind in putting legislation in place. The discussion paper notes that while SARS is not yet ready to implement an APA system, it will begin planning and drafting the required legislation for approval.

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Spain

Carlos Frühbeck

SPAIN

by Carlos Frühbeck

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Introduction and brief overview of transfer pricing regulations in Spain

a) Transfer pricing rules

Transactions between related persons must be assessed at their market value. The following are considered to be related persons or entities:

1. An entity and its members or participants;
2. An entity and its directors or managers, except for when they receive remuneration for the exercise of their functions;
3. An entity and the spouses or persons related by blood to the entity's members or participants, directors, or administrators;
4. Two entities belonging to a group;
5. An entity and the directors or managers of another entity, where both entities belong to a group;
6. An entity and another entity in which the former holds indirectly at least 25% of the share capital or equity;
7. Two entities in which the same partners, participants or their spouses, or persons related by blood or marriage hold at least 25% of the equity.
8. An entity resident in Spanish territory and its permanent establishments abroad.

b) Transfer pricing valuation methods

Any of the following methods are applicable in Spain:

1. Comparable free price method, which compares the price of the good or service in a transaction between related persons or entities with the price of an identical or similar good or service in a transaction between independent persons or entities in comparable circumstances.
2. Cost plus method, whereby the usual margin in identical or similar transactions with independent persons or entities is added to the acquisition value or production cost of the good or service.
3. Resale price method, which

subtracts from the sale price of a good or service the margin applied by the reseller in identical or similar transactions with independent persons or entities.
4. Profit or loss allocation method, whereby each related person or entity that jointly enters into a transaction is allocated a share of the common profit or loss arising from that transaction on a basis that reflects the terms and conditions that would have been subscribed to by independent persons or entities in similar circumstances.
5. Net operating margin method, whereby the net result, calculated based on costs, sales, or the most appropriate amount based on the characteristics of identical or similar transactions carried out between independent parties, is attributed to transactions carried out with a related person or entity.

Where it is not possible to apply the above methods, other generally accepted valuation methods and techniques that respect the arm's length principle may be used.

c) OECD guidance

Spanish law regulates that the interpretation of the legislation governing related-party transactions must be made in accordance with the OECD Transfer Pricing Guidelines and the recommendations of the EU Joint Transfer Pricing Forum, to the extent that they do not contradict what is expressly stated in the Law.

d) Reporting requirements

Taxpayers who carry out the following transactions with related persons or entities are obliged to prepare transfer pricing documentation:

- Transactions with the same person or related entity, provided that the amount of all the transactions in the tax period exceeds EUR 250,000.
- Transactions that use the same valuation method, provided that the aggregate amount of such transactions exceeds 50% of the entity's turnover.
- The following transactions,

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provided that the combined amount of each such transaction in the tax period exceeds EUR 100,000:

1. Transfers of business.
2. Transactions involving of shares representing the equity of entities not traded on any regulated markets.
3. Transactions in real estate and intangible assets.

- Transactions with so-called non-cooperative jurisdictions, irrespective of the amount involved.

Transfer pricing documentation in Spain

Taxpayers required to prepare transfer pricing documentation must prepare the following documentation.

Master file

Minimum content of the master file:

1. Description of the organisational, legal, and operational structure of the group.
2. Identification of the entities forming part of the group.
3. Principal activities of the group, main geographical markets, main sources of profits, and supply chain.
4. General description of the functions performed, risks assumed, and assets used.
5. Description of the group's transfer pricing policy.
6. Description of cost-sharing arrangements and service contracts between group entities.
7. Description of relevant acquisitions or disposals of assets during the tax period.
8. Overview of the group's overall strategy concerning intangible assets.
9. List of the group's intangible assets relevant for transfer pricing purposes.
10. Agreements between group entities relating to intangibles.
11. General description of the group's financing arrangements.
12. Identification of the group entities performing the main group financing functions.
13. Consolidated annual financial statements of the group.
14. Previous valuation agreements in force.

Local file

Minimum content of the local file:

1. Management structure of the taxpayer.
2. Description of the taxpayer's activities and business strategy.
3. Main competitors.
4. Description of the nature, characteristics, and value of the related party transactions.
5. Name, tax domicile and TIN of the related persons or entities involved.
6. Comparability analysis.
7. Explanation of the selection of the chosen valuation method.
8. Prior valuation agreements in force with any tax authority.
9. Financial data of the

comparables used and the source from which they were obtained.

Penalties

Failure to provide, or the incomplete or false provision of, TP documentation is considered a serious tax offence. This infringement is sanctioned as follows:

1. If the tax authorities do not to make corrections to the tax base:

- Fixed penalty of EUR 1,000 for each piece of information, and EUR 10,000 for each set of omitted or false information.
- The penalty shall be capped at the lower of the following two amounts:
  - 10% of the aggregate amount of the related transactions carried out in the tax period
  - 1% of net turnover.

2. If the tax authorities make corrections to the tax base:

- Penalty of 15% of the amount of the corrections made for each operation.

Economic analysis

The following circumstances shall be considered in the economic analysis:

1. Specific characteristics of the goods or services delivered;
2. Functions assumed by the parties, identifying the risks assumed and weighting the assets used;
3. Contractual terms of the transactions;
4. Economic circumstances that may affect the related transactions; and
5. Business strategies.

Internal or external comparables to be considered should be indicated.

Two or more transactions are comparable where there are no material differences in circumstances affecting the price of the good or service or the margin of the transaction, or where such differences can be eliminated by making the necessary comparability adjustments.

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Advanced pricing agreements (APAs), dispute avoidance and resolution

It is possible for taxpayers to reach agreements with the tax administration on the valuation of transactions with other related taxpayers prior to their execution. Through these agreements, the market value of the transaction is determined in advance at the taxpayer's request based on the proposal submitted by the taxpayer and using any of the valuation methods admitted by law.

Given that the related parties may be located both in Spanish territory and abroad, it is normal to involve the respective tax administrations in which the parties reside to ensure that joint taxation does not exceed the income obtained.

Switzerland

Marc Nideröst

SWITZERLAND

by Marc Nideröst

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Introduction and brief overview of transfer pricing regulations in Switzerland

Switzerland has not issued any specific transfer pricing regulations. According to Swiss law, supply relationships between related parties must be determined according to the third party prices respectively — the arm's length transfer prices.

According to the jurisprudence of the Swiss Federal Supreme Court, an entity is considered related, if, primarily a commercial or secondarily a personal, close relationship exists between the two entities. Therefore, direct or indirect participation in the management, control, or capital is not required. The crucial question is whether the tested transaction was conducted only as a consequence of the associated relationship or not.

Transfer price adjustment in Switzerland is based on the principle of the prohibition of harmful profit shifting between related parties. According to settled case law of the Swiss Federal Supreme Court, harmful profit shifting occurs when:

- A company provides consideration without corresponding counter payment;
- The consideration was provided to a shareholder or related party;
- The consideration would not have been granted to a third party; and
- The disproportion between the consideration and the counter payment would have been clearly evident to the company.

Although the Swiss legislature has refrained from including specific transfer pricing provisions in the tax law, there are a number of administrative instructions that, implicitly or explicitly, refer to the determination of consistent transfer prices, and, in particular, instruct the cantonal

tax authorities to follow OECD transfer pricing guidelines when assessing transfer prices.

I. Transfer pricing documentation in Switzerland

As an OECD member state, Switzerland has undertaken to implement the OECD BEPS minimum standards (including BEPS Action Item 13: Country-by-Country Reporting). Country-by-Country reporting (CbCR) is mandatory for multinational enterprises with total consolidated group revenue of CHF 900 million or more.

The CbCR law contains notification mechanisms that apply to ultimate parent entities and surrogate parent entities in Switzerland. Furthermore, there are also non-compliance penalties related to CbCR – penalties for non-filing or late filing, penalties for incorrect or inaccurate filing, and general penalties for non-compliance with the Swiss Federal Tax Administration's orders. Switzerland also conducts inspections to verify that the constituent entities have met their obligations.

Beyond the mandatory CbCR, there are no additional specific requirements concerning transfer pricing documentation. However, based on Art. 126 of the Federal Tax Act, taxpayers must do everything possible to enable a complete and correct assessment, and, at the request of the assessment authorities, provide information orally or in writing, and submit business books and other documents on business transactions.

Companies are therefore obliged to provide the tax authorities, upon request, with all information, including records of intragroup transactions, needed for a complete and correct assessment. In practice, the

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local file and master file documentation approach laid down in the OECD Transfer Pricing Guidelines is used to structure the documentation. Sanctions may apply if the taxpayer does not collaborate with the tax authorities.

Under the ordinary tax procedure and provided a non-arm's-length transaction is considered by the tax authorities, penalties do not generally apply in practice and late interest fees are privileged. However, penalties may occur, particularly where tax fraud is considered. Penalties are generally assessed in view of the taxpayer's fault. They can be challenged during administrative or criminal proceedings by providing relevant evidence or facts, or during later legal proceedings in front of the Swiss courts up to the Swiss Federal Supreme Court.

II. Economic analysis and how to demonstrate an arm's length result

Switzerland relies on the methods suggested in the OECD Transfer Pricing Guidelines (TPG), without having any direct reference to any method in its domestic legislation. In order to select the appropriate method, Switzerland will typically look at the nature of the taxpayer's controlled transactions through a functions, assets, and risks (FAR) analysis.

The availability of reliable information and uncontrolled comparables will then be assessed and compared to the controlled transactions. Finally, Switzerland will evaluate the need for comparability adjustments. In practice, statistical tools that take into account central tendencies like the interquartile range or other percentiles are usually used to narrow the range.

Besides the OECD TPG, the Federal Tax Administration (FTA) has issued circulars containing safe harbours rules concerning thin capitalisation and intragroup interest rates.

III. Advanced pricing agreements (APAs), dispute avoidance and resolution

Advance tax rulings are common. Taxpayers may request advance rulings from the Swiss tax authorities to learn how they will be subject to Swiss tax law and how much they will owe in Swiss taxes. The system of advance rulings reduces the number of tax-related disputes litigated before the courts.

Switzerland does not have a formal Advances Pricing Agreement (APA) programme in place, but it is authorised to enter into unilateral, bilateral, or multilateral APAs on the basis of the Mutual Agreement Procedure (MAP) provision in the applicable tax treaty. This allows for rollbacks of APAs, if they are within Switzerland's domestic time limit of 10 years. Usually, Switzerland seeks to settle on a 5-year agreement, but this can vary in practice. Moreover, Switzerland has extensive experience in the resolution of MAPs.

In the case of a MAP, APAs, the master file and local file, and all other relevant information for the resolution of the case are usually required.

The cantonal tax authorities are responsible for assessing direct federal and cantonal taxes and the FTA plays a supervisory role. The Swiss tax authorities do not usually perform transfer pricing investigations. However, based on ordinary taxation procedure, assessment authorities will review taxpayer declarations and carry out necessary investigations.

Furthermore, tax authorities may audit taxpayers. Accordingly, taxpayers should retain all documents necessary to prove that the transfer prices were made in accordance with the arm's length principle. The burden of proof rests on the taxpayer to prove that expenses were justified, and the tax authorities must offer proof for adjustments that increase the taxpayer's taxable income. In recent years, there has been an increase in the number of audits performed by Swiss tax authorities.

Decisions made by cantonal authorities may be challenged before the cantonal courts, and decisions made by federal tax authorities may be challenged before the Swiss Federal Administrative Court. All decisions may be appealed to the Swiss Federal Supreme Court.

United Kingdom

Alan Rajah

UNITED KINGDOM

by Alan Rajah

Global transfer pricing disputes are escalating, subjecting multinational companies to heightened scrutiny in their transfer pricing practices.

Transfer pricing plays a crucial role in influencing the application of other tax regulations, as it adheres to the concept of the arm's length principle, which directly affects tax calculations.

UK statistics from His Majesty's Revenue and Customs (HMRC) reveal a remarkable surge between 2016 and 2021 of 250% in transfer pricing yield, surpassing GBP 2 billion during the 2020–21 UK financial year.

Although 2021–22 data indicates a rise in enquiry numbers but a decline in yields, it underscores HMRC's intensified focus on intricate transfer pricing matters and the substantial stakes involved.

Transfer pricing rules

The UK's transfer pricing (TP) rules under Part 4 TIOPA 2010 are built upon the foundation of the arm's length principle, as per Article 9 of the OECD Model Tax.

The basic rule states that if a transaction between related parties could lead to a tax advantage, the profits and losses of the advantaged party should be calculated as if the transaction was done at a fair

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market price.

This principle-based model approach allows for a broader application to a wide range of transactions.

The UK also employs the tax advantage rule, often known as the "one-way street", which prevents unilateral negative adjustments to profits or losses that could lead to non-taxation.

UK enterprises, including foreign entities operating in the UK through a permanent establishment, are subject to TP rules unless specific exemptions apply.

For larger groups with annual consolidated revenue exceeding EUR 750 million, the UK has implemented country-by-country reporting requirements and TP documentation obligations.

There are exemptions to the basic TP rules in certain situations, such as transactions involving small or medium-sized enterprises (SMEs). In order to reduce the compliance and cost burdens for SMEs, HMRC introduced simplified transfer pricing arrangements.

Transfer pricing methods

The UK follows the OECD guidelines and accepts various TP methods, including the comparable uncontrolled price, resale price, cost plus, transactional net margin, and profit split methods. Companies may use other methods if they are justifiable and appropriate.

Selecting the most appropriate method depends on the functional and risk profile of the entities, and its relevance should be carefully considered for each transaction.

OECD guidance

The UK's TP rules explicitly reference the OECD guidelines, emphasising their importance in interpreting and applying the arm's length principle. This alignment ensures consistency and global harmonisation in transfer pricing practices.

Reporting requirements

UK enterprises are responsible for self-assessing their compliance with TP rules when filing tax returns. If an enterprise is deemed an

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"advantaged person", it must make necessary TP adjustments on their tax returns.

For large groups with annual consolidated revenue exceeding EUR 750 million, the UK has implemented Country-by-Country Reporting (CbCR) requirements. CbCR aims to enhance transparency by requiring multinational enterprises to provide information on their global allocation of income, taxes paid, and other indicators of economic activity.

Since 01 April 2023, there has been a standardised approach for TP documentation where all larger groups are required to maintain master and UK local files. This requirement is in addition to CbCR. Previously, the UK TP rules did not explicitly require OECD master and local files to be prepared, and only required the provision of "sufficient documentation".

Preparation of transfer pricing documentation

To comply with the UK's TP rules, enterprises are required to prepare documentation which proves that transactions with related parties are conducted on an arm's length basis.

From 01 April 2023, the UK has followed the OECD TP documentation model, requiring the preparation of master files and local files. All documentation must be prepared in English and be available before the tax return deadline and submission. This is crucial as HMRC is able to request the documentation with a 30-day deadline, and failure to respond may result in penalties.

HMRC also planned to introduce the requirement of a summary audit trail – a short questionnaire detailing the main actions undertaken in preparing the local file. However, this has now been delayed pending a consultation in 2023.

Master file and local file

The master file provides an overview of the group's business and nature of its operations, its overall TP policies, and its global allocation of income and economic activity.

The UK local file analyses entity-level arrangements, detailing any material intercompany transactions and transfer pricing positions taken between the UK company and any overseas affiliates. This should include relevant financial information, comparability analysis, and selection method for the most suitable TP method.

UK-UK transactions are not required in the local file, but supporting analysis should be available upon request. Generally, UK-UK-related party transactions are subject to TP rules, but documenting them in the local file is not mandatory.

TP documentation must be preserved for at least 6 years from the end of the accounting period, unless subject to an

HMRC enquiry.

Penalties

The self-assessment approach in the UK implies the potential for interest and penalties for “carelessness” in filing.

Maintaining accurate and complete TP documentation is crucial to avoid penalties and demonstrate compliance with UK rules. Failure to provide adequate records may result in fixed penalties of GBP 3,000, and tax-geared penalties based on the level of inaccuracy.

For the largest businesses, not meeting the requirements leads to a presumption of “careless inaccuracy”, a ruling which can only be overturned with the required documents and evidence. Tax-geared penalties range from 30% to 100% of potential lost revenue depending on the level of inaccuracy and behaviour.

Economic analysis and demonstrating arm's length results

Generally, to establish arm's length pricing, businesses are expected to conduct economic analyses. HMRC encourages businesses to search for potential internal comparables before resorting to external database searches.

In the case of Low Value Adding Services (LVAS), if the simplified approach is used, it should be consistently applied across the group where appropriate. The nature and benefits of LVAS should be documented, along with relevant contracts, allocation keys, and calculations of charges.

Advanced pricing agreements (APAs)

The UK allows businesses to enter into advanced pricing agreements (APAs) with HMRC. These agreements govern the appropriate TP method for a forward-looking period, providing certainty and reducing the risk of disputes.

When double taxation occurs, the Mutual Agreement Procedure (MAP) is also available. The UK's extensive treaty network allows for the resolution of TP disputes through negotiation with the treaty partner.

Conclusion

Navigating the UK's transfer pricing regulations requires a comprehensive understanding of the legislation and compliance obligations. By adhering to the requirements for TP documentation, conducting economic analyses, and utilising mechanisms such as APAs and MAPs, enterprises can ensure compliance with UK transfer pricing rules. Staying informed about the evolving nature of TP regulations is essential to mitigate risks, avoid penalties, and foster certainty in cross-border transactions.

USA

Fernando Lopez and Derek Morgan

USA

by Fernando Lopez and Derek Morgan

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Introduction to transfer pricing in the United States

Section 482 of the Internal Revenue Code (IRC) authorises the US Internal Revenue Service (IRS) to adjust the income, deductions, credits, or allowances of commonly controlled taxpayers to prevent evasion of taxes or to clearly reflect their income. The regulations under section 482 generally provide that the price charged by one affiliate to another, in an intercompany transaction involving the transfer of goods, services, or intangibles, yields results that are consistent with the results that would have been realised if uncontrolled taxpayers had engaged in the same transaction under the same circumstances.

a) Transfer pricing rules

United States TP rules are based on the arm's length principle and their purpose is to ensure that taxpayers clearly reflect income from "controlled transactions", and do not evade taxation by artificially shifting income between different tax jurisdictions. A transaction is a controlled transaction for IRC 482 purposes if the transaction is between two or more organisations, trades, or businesses that are either: 1) owned; or 2) controlled by the same interests.

b) Transfer pricing methods

US TP methods generally follow and are consistent with the TP methods outlined in the OECD guidelines. For transactions involving tangible goods, commonly accepted methods are the CUP, resale price, cost plus, CPM, profit-split, and unspecified methods. For intangible goods, acceptable methods include the comparable uncontrolled transaction (CUT), CPM, profit-split, and unspecified methods. For services, acceptable

methods include the services cost, comparable uncontrolled services price, gross services margin, cost of services plus, CPM, profit-split, and unspecified methods. For cost sharing agreements involving buy-ins of existing intangibles, acceptable methods are the CUT, income, acquisition price, market capitalisation, residual profit split, and unspecified methods.

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Under the Best Method Rule, given the facts and circumstances of the transactions under review, the pricing method selected should provide the most reliable measure of an arm's length result relative to the reliability of the other potentially applicable methods.

c) OECD guidance

US TP regulations are consistent with the OECD Transfer Pricing Guidelines (TPG). This includes US rules related to cost sharing arrangements (CSAs) that are consistent with the guidance on cost contribution arrangements in chapter 8 of the OECD TPG. In general, the US has agreed to the broad parameters of the OECD's proposals on country-by-country reporting (CbCR), and master file and local rules under OECD Action 13. The IRS plans to implement CbCR at this time, however, only once basic data has been released for groups with revenues in excess of USD 850 million.

d) Reporting requirements

Taxpayer preparation of TP documentation is not mandatory. However, taxpayers who do not have documentation on hand when audited by the IRS are subject to a net adjustment penalty that is to be assessed in every case where the penalty thresholds are met.

Transfer pricing documentation in the US

a) Preparation of transfer pricing documentation

Taxpayers must maintain two categories of documentation – principal documents and background documents.

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The principal documents include:

1. A general overview of the business, including economic and legal factors affecting pricing;
2. A description of the organisational structure;
3. Any documentation related to a qualified cost sharing arrangement;
4. A description of the method selected and reasons for the selection;
5. A description of controlled transactions and method used to analyse the transactions;
6. An explanation of economic analysis and projections relied upon in developing the method;
7. A description of any data obtained after the tax year and before filing a tax return; and
8. A general index of the principal and background documents, including the record system used for cataloguing these documents.

Background documents support the assumptions, conclusions, and positions in the principal documents, and demonstrate how the taxpayer's method was selected and applied to provide the most reliable measure of an arm's length result. Background documents need not be provided to the IRS unless they are specifically requested.

b) Compliance with OECD master and local file documentation in the US

The US has not adopted the OECD's master file and local file concept. However, for larger taxpayer groups (over EUR 750 million), the US has implemented Country-by-Country Reporting.

c) Penalties

IRC sections 6662(e) and (h) set forth penalties when IRS TP adjustments lead to increased taxes. A 20% penalty is assessed as a substantial valuation penalty and is applied if the price or value is 200% or more (or 50% less) than the correct amount, or the net adjustment exceeds the lesser of USD 5 million or 10% of gross receipts. A 40% penalty is a gross valuation penalty, and is based on price or value change of 400% or more (or 25% or less) than the correct amount, or a net adjustment that exceeds the lesser of USD 20 million or 20% of gross receipts.

Adjustments are excluded from the penalty calculation if the taxpayer applies a specified or unspecified method under the best method rule, and if the taxpayer has created TP documentation by the time the taxpayer files their return for each specific year. If a taxpayer is audited, the IRS can request TP documentation and will give the taxpayer 30 days to respond with such documentation before penalties can be assessed.

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Economic analysis and how to demonstrate an arm's length result

As previously stated, a taxpayer in the US may select any particular method that is reasonable and determinable from all facts and circumstances. The ultimate economic method selected for controlled transactions should be based on the following criteria:

1. The experience and knowledge of the taxpayer;
2. The extent to which the taxpayer obtained accurate data and analysed it in a reasonable manner;
3. The extent to which the taxpayer used the most current reliable data for the tax year in question;
4. The extent to which the taxpayer reasonably followed the relevant requirements in the section 482 regulations;
5. The extent to which the taxpayer reasonably relied on a study or other analysis prepared by a professional;
6. The extent to which the taxpayer used more than one uncontrolled or arbitrarily selected comparable, providing a result that did not represent the overall business of the taxpayer;
7. The extent which the taxpayer relied upon TP methods developed and applied under an advanced pricing agreement for a prior year (assuming facts and circumstances have had no material changes); and
8. The size of the net TP adjustment in relation to the size of the controlled transaction which gave rise to the adjustment.

All of these factors must be considered in preparing the principal documents on which the taxpayer intends to rely.

Advanced pricing agreements

In situations where there is uncertainty about what constitutes an arm's length price, taxpayers have the option of entering into an advanced pricing agreement (APA) with the IRS. APAs typically cover a term of five years but can be adjusted to cover previous and prospective years as appropriate. The IRS typically prefers bilateral APAs, and charges a substantial fee to cover the administrative costs of reviewing an APA.

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