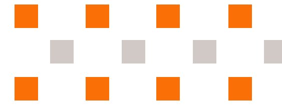

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NEWS 3/2015

News Nr. 3/2015

Weiterer WTS Newsletter zum Thema Verrechnungspreise

Wie wir Sie bereits informiert haben, hat WTS Alliance (deren Bestandteil unsere Kanzlei WTS Alfery als unabhängiges Mitglied ist) ein spezielles Team gebildet, das sich mit Verrechnungspreisen beschäftigt (WTS Global Transfer Pricing Team).

Seine Tätigkeiten umfassen unter anderem die Veröffentlichung eines speziellen Newsletters, der sich ausschließlich Verrechnungspreisen widmet (WTS Transfer Pricing Newsetter).

Wir übersenden Ihnen hiermit die zweite Ausgabe 2015.

Der Newsletter bietet eine Übersicht über die Entwicklungen im Bereich der Verrechnungspreise in 12 Ländern, welche durch die lokalen Verrechnungspreis-Experten in der WTS Alliance vorbereitet wurde.

Der Newsletter widmet sich insbesondere der Base Erosion and Profit Shifting (BEPS)-Initiative der OECD. Sie beschäftigt sich mit den Praktiken zur Minimierung der Steuerpflicht durch geplante Verminderung steuerlicher Bemessungsgrundlagen und das grenzüberschreitende Verschieben von Gewinnen.

Ferner informiert der Newsletter über neue spezifische Regelungen für Verrechnungspreise in den einzelnen Ländern, wie z.B. in den Niederlanden, Großbritannien oder China.

Wir hoffen, dass Sie den Newsletter interessant finden.

Für etwaige Rückfragen stehen wir Ihnen jederzeit zur Verfügung.

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Verwenden Sie, bitte, die Informationen in diesem Material nie als Grundlage für Ihre Entscheidungen, nehmen Sie die professionellen Dienstleistungen unserer qualifizierten Spezialisten in Anspruch.

June 2015
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WTS Transfer Pricing Newsletter

Editorial

Dear Reader,

We are pleased to provide you with issue #2.2015 of our WTS Transfer Pricing Newsletter on recent international transfer pricing developments.

In this issue of the newsletter we again deal with the BEPS initiative by the OECD, as well as specific new regulations of individual countries regarding transfer pricing.

While in Germany the BEPS action points were already partially anchored in national law even before the actual BEPS discussion and possibly further points will be added in near future (we expect an expansion of the documentation requirements in Germany with the effect that the three-part OECD documentation concept with Master File, Local File and Country by Country (CbC) File is transferred into national German Tax Law), other countries will probably introduce documentation requirements for the first time (please see our article from Belgium), change their documentation approach (please see our article from Poland) or introduce special CbC documentation requirements (please see our article from the USA) presumably due to the BEPS discussion and public pressure.

In addition, this issue also deals with other country-specific transfer pricing topics, reaching from articles that show the general transfer pricing rules of a country (please see our article from Nigeria) and the release of new special transfer pricing rules (e.g. in Ukraine about commodity transactions with low-tax countries and in Italy about the treatment of price adjustments because of tax audits), to the introduction of a new tax on "taxable diverted profits" when there is an "avoided permanent establishment ("PE")" or a "lack of economic substance" (please see our article from UK) and the clarification of special cases (please see e.g. our article from the Netherlands with regard to loan pricing in connection with a parent guarantee).

We hope to offer you an interesting range of topics and countries and hope you enjoy reading. If you have questions, we are of course at any time available for further discussion.

Yours sincerely
WTS Global Transfer Pricing Team

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Belgium

Finance Minister considers new TP Documentation Rules

Until today, Belgium does not have any formal transfer pricing rules. There is no mandatory disclosure of intercompany transactions in the tax return, nor is there any obligation to keep a transfer pricing documentation file. A practice note encourages corporate taxpayers to keep appropriate documentation on their intercompany transactions. At the occasion of a tax audit, the TP documentation file prepared by the taxpayer has to be accepted by the tax inspectors. TP documentation may not be binding to the tax authorities if the tax inspector can demonstrate that the factual circumstances do not match with the facts and assumptions as described in the documentation file. Tax authorities may also challenge the TP methodology used if the methods used generate a non at arm's length outcome.

This approach is about to change. During a hearing in Belgian Parliament's Finance Commission, the Finance Minister referred to the guidelines on documentation in the BEPS reports. It is expected that implementation of the BEPS initiatives in Belgium will result in increased efficiency of TP audits and to more legal certainty for taxpayers. Belgian government supports the introduction of documentation requirements, if these new rules are well balancing the compliance burden for enterprises with the need for more transparency in TP matters. The new documentation rules should also clearly define who has the burden of proof. The central tax authorities are currently examining the feasibility of these new documentation requirements.

We expect that the new Belgian TP documentation rules will be aligned with the OECD transfer pricing guidelines and recommendations made in the context of the BEPS initiative. Also earlier recommendations brought forward by the EU joint transfer pricing forum (i.e. an advisory body on transfer pricing matters to the EU Commission) would in all likelihood be adopted. Consequently, multinational companies already having OECD compliant TP documentation would have to make minimal efforts in order to meet the new rules. It is likely that special measures will be taken in order to minimize compliance efforts to be made by SMEs.

In the normal course of events, more information on the new documentation rules will be available later this year. The new rules would then enter into force in the course of 2016. We will publish an update in this newsletter as soon as more information is available.

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China

China is amending its tax collection law, and scrutinizing outbound payments

Amendment to Tax Collection Administration Law is proposed

On 5 January 2015, China State Council released a draft on Taxation Collection Administration Law (TCAL) for public consultation. The draft has proposed some changes to strengthen tax collection from individuals, enhance the protection for taxpayers' rights, and standardize tax collection procedures. In particular, the draft proposes that the tax authority can ask for tax planning schemes from the taxpayers and their tax agents in a transfer pricing audit. It is considered as an echo to OECD's Base Erosion and Profit Shifting (BEPS) action plan No. 12: mandatory disclosure rules.

It is not clearly stated in the draft that who has the disclosure obligation, both taxpayers and the tax agents or either of them; and to what extent the tax planning schemes shall be disclosed, etc. Detailed implementation rules are expected to be rolled out by the Chinese tax authority. Aggressive tax planning on transfer pricing will likely be targeted by the new TCAL.

Intra-group outbound payment in scrutiny

On 18 March 2015, the State Administration of Taxation (SAT) released Public Notice 16, outlining its position on the outbound payments from transfer pricing perspective. It reemphasizes that taxpayers must comply with the arm's length principle when making payments to its overseas related parties. The tax authority can require taxpayers to provide documentation such as agreements and other documents to verify the authenticity, and justify the arm's length nature of the transactions.

It further specifies the following four types of outbound payments that should not be deductible for enterprise income tax (EIT) purpose: 1) payments made to overseas related parties which do not undertake functions, bear risks or have no business substances; 2) intercompany service payments that are not related to the taxpayers' operations, or the taxpayers are not benefited from the services rendered; 3) royalties paid to overseas related parties who only own the legal rights of the intangible assets but having no contribution to the value creation, and not comply with arm's length principle; 4) royalties paid to overseas related parties for the collateral benefits generated from the activities of financing for public listing activities.

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Taxpayers are suggested to consider the following actions to mitigate intra-group outbound payment risks:

1. Ensure the form and substance of transactions are properly included in the agreement.
2. Prepare adequate documentation to support the authenticity of the transactions.
3. Conduct transfer pricing study to justify the outbound payments.
4. Review the substance of the transaction to identify any non-deductible risks.

India

Marketing Intangible- triggering point for Transfer Pricing litigation in India for foreign investors

Transfer Pricing (TP) litigation around 'Marketing Intangibles' is one of the most favorite topics for Indian Revenue Authority (IRA). Tax adjustments by IRA have been a bone of contention with foreign investors. TP adjustment on Advertisement, Marketing and Promotional (AMP) expenses incurred by Indian subsidiary distributor, which allegedly result in building a brand of foreign brand owner was challenged by the taxpayers before the court. The controversy was put to rest by the court by delivering a landmark ruling setting out important principles to the concept of marketing intangibles. IRA is of the view that AMP expenses in excess of expenses incurred by comparable companies as a percentage of turnover (popularly known as 'bright line test') needs to be considered as non-routine expenditure. Such a non –routine expenditure is then subject to a reimbursement from the legal owner of the brand plus a markup for promoting brand in India.

In short any expenditure exceeding such 'bright line' would command a cost plus mark up as marketing service provision towards brands development.

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Court held that such 'bright line, test is unwarranted. The said approach is not mandated in the Act or the Rules. The Court stated that the above approach would be like adding and writing words in the statute and the Rules and introducing a new concept which has not been recognized and accepted in any of the international commentaries or as per the general principles of international taxation accepted and applied universally. Incurring advertisement expenses would not necessarily amount to creation of brand. There have been numerous cases wherein brands have been built without incurring substantial advertisement or promotion expenses and vice versa. It would be incorrect to treat advertisement as equivalent or synonym with brand building. The primary being the quality and reputation of the product or name, which is acquired gradually and silently over a passage of time. The distribution and marketing functions are inter-connected and reliable comparable are available, arm's length price could be computed as a package, if required and necessary by making adequate adjustments. When the Revenue authorities come to the conclusion that it is not possible to compute arm's length price without segregating and dividing distribution and marketing or AMP functions, they can so proceed after giving justification and adequate reasons.

Two important take away from the decision are:

(1) Transfer pricing provision will be applicable on AMP expenses incurred by subsidiary distributor in India.
(2) Bright line test could not be applied without any reason to determine Arm's Length Price.

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Case reference: Sony Ericsson Mobile Communications India Pvt Ltd vs. Commissioner of Income Tax-III (Delhi High Court) Date of decision: March 16, 2015.

Italy

Applicability of IRAP to transfer pricing adjustments

The Finance Act 2014 solved a tricky Italian tax issue, rose in 2008, as to whether transfer pricing adjustments are subject to local tax – the Regional Tax on Productive Activities (IRAP) – as well as corporate income tax (IRES). The amendments are supposed to be retroactive but there are grounds to claim that they only apply since 2013. In any case, tax penalties for IRAP transfer pricing adjustments relating to fiscal years 2008 to 2012 will not be imposed.

Italian corporate taxpayers are subject to a regional tax, IRAP ("Imposta Regionale sulle Attività Produttive"), levied on the "net value of production" and allocated to the Italian regions in which the activity is carried on.

IRAP was introduced in 1998 with the declared purpose, inter alia, of starting the process of decentralization and of a regional tax federalism. For the following ten years, the taxable basis was determined according to the law on the computation of the corporate income tax (TUIR). As a consequence, in the case of intercompany transactions with non-resident entities, the arm's length principle, contained in art. 76(5) and 9(3) TUIR, was applicable even for IRAP purpose.

The rules relating to the definition of the IRAP taxable basis were modified with effect from 2008 (Law 244/2007). As a result, there has been so far uncertainty as to whether transfer

pricing adjustments should be subject to IRAP. This lack of clarity has caused an increase in tax litigation with taxpayers arguing that, in the light of the new rules, as the transfer pricing adjustments were not recorded in the taxpayer's financial statements they were not relevant for IRAP purpose. Moreover, whilst the taxpayers were subject to IRAP assessments on transfer pricing adjustments, the Italian tax authority considered IRAP transfer pricing issues not to be included in Mutual Agreement Procedure (MAP) discussions, due to the 2008 legislative changes. This approach could have resulted in many cases of double taxation.

Through the Finance Act 2014, it has been clarified that transfer pricing adjustments arising from tax audit are also relevant for IRAP purposes. The clarification has been made applicable to financial years starting from January 1, 2008. Therefore, this "clarification", introduced by a law dated December 27, 2013, has been given retroactive effect which raise many doubts on its legitimacy.

As far as penalties for inaccurate or frivolous filing of returns are concerned (100%- 200% of underpaid tax), article 1, paragraphs 282-283 Law No. 147/2013 provides that they will not be levied in relation to the additional IRAP applicable to transfer pricing adjustments assessed by the tax authorities for the fiscal years from 2008 up to the one for which, at the date of entry into force of the relevant provision, the deadline for the filing of the tax return has expired (generally FY 2012), unless a prior assessment became final before January 1, 2014 (e.g. by means of settlement or court decision) . Furthermore, the transfer pricing penalty waiver does not apply to notices of assessment notified prior to January 1, 2014 in the case of final tax measure imposing penalties at this data . Special rules apply for taxpayers whose financial year does not match the calendar year.

As a consequence, if the Italian taxpayer cannot benefit from the penalty protection guaranteed by the transfer pricing documentation, the following different scenarios could arise:

a) transfer pricing adjustments relating to fiscal years 2008 to 2012 and the tax measure imposing penalties was already final at January 1, 2014 => penalties;
b) transfer pricing adjustments relating to fiscal years 2008 to 2012 and notice of assessment notified after January 1, 2014 => no penalties;
c) transfer pricing adjustments relating to fiscal years 2008 to 2012 and notice of assessment notified before January 1, 2014 in the case of final tax measure imposing penalties at January 1, 2014 => penalties;
d) transfer pricing adjustments relating to fiscal years 2008 to 2012, the assessment was not final at January 1, 2014 => no penalties.

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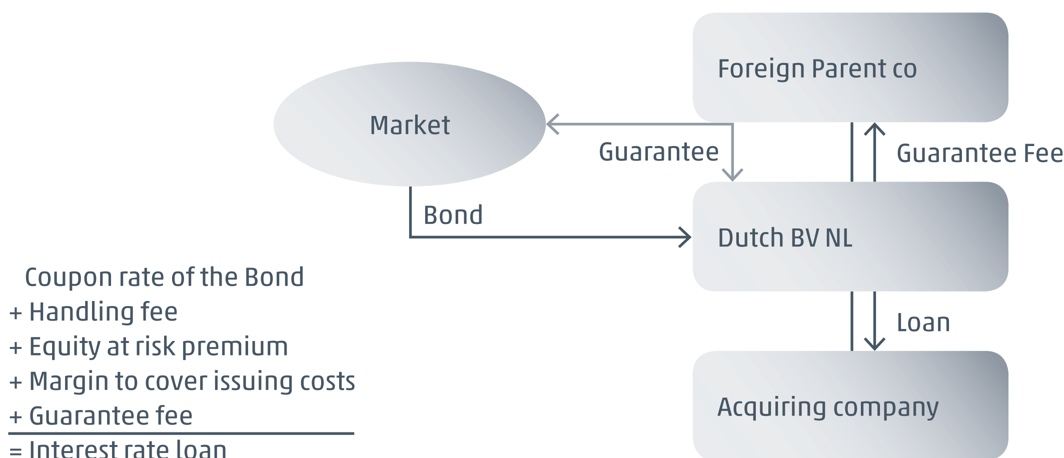
The Netherlands

Loan pricing and a (parent) guarantee

The Dutch ruling practice is thorough and solid (confirmed by the EU commission). Many multinationals seek a Dutch ruling to obtain 100% certainty on uncertain tax positions in advance. This also concerns loan pricing for companies established in The Netherlands. Consequently a mature practice exists in the Netherlands regarding loan pricing.

Recently WTS NL assisted a foreign multinational with determining the arm's length interest rate of a back-to-back financing structure. A Dutch group company issued a bond that was guaranteed by the foreign parent company of the group. The proceeds of the bond were

lent on to a related foreign group company to finance the acquisition of another multinational. The choice for the Dutch BV to issue the bond was based on the knowledge and tax certainty that can be obtained in The Netherlands and on the fact that Dutch BV had sufficient substance.



The arm's length interest rate on the loan from Dutch BV to the group company was based on the interest of the bond. The interest on the bond was regarded arm's length, given that the bond was issued by Dutch BV to third parties. The arm's length remuneration for Dutch BV consisted of an interest spread. The interest spread plus interest of the bond formed the arm's length interest rate for the group company lending the proceeds of the bond from Dutch BV.

The interest spread took into account the activities and risks of Dutch BV, the issuing costs of the bond and the parent guarantee. Through a benchmark study, a range of handling fees was identified to determine an arm's length remuneration for the activities of Dutch BV. Based on information from a database and on the credit rating of a subordinated loan, an equity at risk premium was calculated to determine an arm's length remuneration of the risks of Dutch BV in relation to the back-to-back financing. This equity at risk premium also took into account the guarantee of the parent company to limit the equity at risk of Dutch BV to €2 million. The limitation of the equity at risk to 1% of the loan with a maximum of €2 million is in line with Dutch legislation.

The issuing costs were financed by Dutch BV and not charged as such on to the lending group company. Instead, in the interest spread a margin was included to cover the issuing costs during the term of the loan. Also a guarantee fee was included, to be paid to the parent company that gave the guarantee to the market and gave a guarantee to Dutch BV to limit the equity at risk on the back-to-back financing to €2 million. WTS NL performed several benchmark studies to determine the guarantee fee.

The Dutch tax authorities take the position that when a loan can be obtained with a guarantee only, the guarantee is given out of shareholder motives. Such guarantee would not qualify as a service and therefore a guarantee fee would not be regarded arm's length by the Dutch tax authorities in such situation. Moreover, the Dutch tax authorities qualify a third party loan as an intercompany loan when it cannot be obtained without the guarantee of the group company.

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Given that the proceeds of the bond were used to acquire a multinational with a sufficient rating, we have assumed that Dutch BV also would have been able to issue the bond in the market without the parent guarantee. Given the lower credit rating of the multinational that was acquired, it was concluded that the guarantee by the parent company to the bond holders lead to a lower interest rate, given that the bond was rated with the same rating as the group rating, despite the much lower rating of the group that was acquired with the proceeds of the bond.

The Dutch tax authorities take the position that the acceptable level of the guarantee fee would not be higher than the difference between the interest percentage with the explicit guarantee of the parent company, i.e. the interest rate of the bond, and the interest percentage with an implicit parent guarantee, i.e. the interest rate based on the credit rating that is not based on the individual stand-alone rating of Dutch BV only, but which also takes into account that Dutch BV forms part of a group. Although the tax authorities in the various countries often may have different views regarding the (appropriate) guarantee fee, in the case at hand the guarantee fee that was established this way, was approved by the local tax authorities of the parent company through a ruling.

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Nigeria

Recent Updates on Transfer Pricing in Nigeria

General Updates

There have been no changes to the legislation since the Nigerian Transfer Pricing (TP) regime officially commenced in 2012, with the introduction of the Income Tax (Transfer Pricing) Regulations No.1 2012 (the TP Regulations). The Federal Inland Revenue Service (FIRS) has however, commenced the implementation of the TP regime with the first set of TP returns for 2013 financial year transactions filed in 2014.

To show its readiness the FIRS set up a TP division with the mandate to drive TP in Nigeria. The TP division has further to this mandate issued demand notices to companies that failed to file TP returns alongside their 2013 financial year income tax returns - as income tax returns without TP returns is not considered "complete" compliance with tax returns filing provisions under the law. The FIRS also insists that companies are to file "nil TP returns" even where no controlled transactions are carried out in any financial year.

To ensure TP compliance by non-resident companies operating in Nigeria, the FIRS recently issued a public notice mandating non-residents doing business in Nigeria to file their tax returns based on their actual assessment with effect from the 2014 financial year. The practice before now was to tax non-resident companies doing business in Nigeria on turnover basis with 20% of the turnover deemed the assessable profits taxable of the company taxed at the rate 30%. With the above development, it is prudent for such non-resident companies to maintain proper documentation of incomes earned and expenses incurred.

TP Documentation

Connected Taxable Persons (CTPs) doing business in Nigeria are under obligation to keep written records of information sufficient to prove that the pricing of any transaction with any connected party is consistent with the arm's length principle. Such records must be kept for a period of six years and must be in English. TP documentation must be in place prior to

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the due date for filing the income tax returns for the financial year and must be made available to the FIRS within 21 days of request.

The good news for multinationals with global TP policies is that such policies if localized to suit Nigerian operations would be suitable and accepted by the FIRS since there is no particular format to be adhered to. However for companies without existing TP policies, the fact that there are no local databases of comparables might pose a challenge, as they would have to look to other African countries such as South Africa or OECD countries for suitable comparables to arrive at pricing justifications to be inserted in their TP policies.

Advanced Pricing Agreements

Taxpayers may enter into Advance Pricing Agreements (APA) with the FIRS as well as with both the FIRS and the tax authority of the taxpayer's country of residence. The minimum annual transaction value for a company to enter into an APA is NGN 250,000,000.00 (about USD 1,250,000.00) and the term/duration of the APA must not exceed three years. However, the FIRS has hinted that it will not enter into any APA until the Nigerian TP regime advances. The primary advantage of an APA is the advanced approval of the TP methodology applied by the taxpayer, providing certainty of the outcome of examinations of TP methodologies by the FIRS. Unnecessary challenges and surprises might arise as a result of the absence of an APA as taxpayers are not assured of the outcome of examinations of TP methodologies in advance.

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Philippines

Advance Pricing Agreement in the Philippines

On January 3, 2013, the Department of Finance issued the much awaited Revenue Regulations (RR) No. 2-2013 to address the issue on Transfer Pricing affecting both cross-border and domestic transactions between associated enterprises. RR No. 2-2013 is the consolidated transfer pricing rules and regulations in the Philippines.

The Bureau of Internal Revenue (BIR) is currently drafting another revenue regulation prescribing the guidelines and procedures in administering the Advance Pricing Agreement (APA) program. In fact, on October 17, 2014, the Tax Bureau invited panelists from both the private and public sector for a roundtable discussion on the salient provisions of the draft RR on APA.

The original draft presented the establishment of an APA with the Commissioner of Internal Revenue who shall act as the Competent Authority; provides guidelines for initiating the APA process; prescribes the procedures in processing the APA applications; prescribes the APA forms and documentation requirements; and provides guidelines during the implementation period of the APA.

The proposed APA program is a voluntary program whose goal is to increase efficiency in the tax administration and reduce taxpayer compliance burden in resolving transfer pricing issues. The BIR and taxpayer agree in advance of the execution of covered transaction the most appropriate transfer pricing method in respect of the transaction.

Based on the draft regulation, participation to the APA program is initiated by the taxpayer through the filing of an APA application.Under the APA process, the taxpayer proposes a

transfer pricing method with respect to the related party transaction and provides relevant data and information to show that its proposed method is the most appropriate transfer pricing method.

An APA is confidential, contractual in nature and works on a prospective basis. An APA has specific duration of three (3) years and applies only to the proposed covered transactions. The APA process covers related party cross-border transactions including the following:
a) sale, purchase, transfer and use of tangible property;
b) transfer and use of intangible property;
c) financing; and
d) provision of services.

The APA process has six (6) stages: (a) Pre-filing; (b) Formal filing; (c) Fact-finding and Review; (d) Discussions and Negotiations; (e) Signing of the APA; and (f) Implementation and Monitoring.

Note that under the APA program, taxpayers who file a request for Pre-filing Conference shall automatically be enlisted with the Large Taxpayers Service (LTS). If a taxpayer wishes to apply for an APA for a proposed covered period, he should submit the APA application no later than twelve (12) months before the first day of the proposed covered period.

Upon advice of the merit of the application, the taxpayer shall formally file the APA application together with all the supporting documents and electronic filing and payment of a filing fee in the proposed amount of P2.5Million. During the formal filing stage, the taxpayer is required to file a waiver of domestic time limits on assessment.

Following the review and negotiation stage, the Competent Authority shall formalize the APA. The concluded APA shall be a binding agreement between the taxpayer and the BIR. During the implementation and monitoring stage, the taxpayer shall file with the LTS an Annual Compliance Report otherwise failure will lead to the cancellation of the APA and the taxpayer is thus open to audit. The APA may be revised, pre-terminated, revoked or renewed depending on the circumstances.

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Poland

Intensified tax audits on transfer pricing expected

NIK report says: transfer pricing causes the drop in CIT revenues

In January 2015 the Supreme Audit Office (further: NIK, the independent audit agency safeguarding public spending) issued a report concerning the control over the correctness of tax settlements made by Polish subsidiaries of foreign companies.

NIK revised the actions taken by the Polish Ministry of Finance (hereinafter: MoF) over the period from 1 January 2012 till 30 June 2014 in order to eliminate the mechanisms for aggressive tax planning.

The NIK noticed that the corporate income tax flows has been dropping over last year while the tax rate remained stable (19%). According to the NIK the above results from profit shifting and the transfer pricing practices applied by the local subsidiaries of the multinational groups.

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NIK noticed that the inspectors are not equipped adequately to audit transfer pricing efficiently. Apart from the technical training on the transfer pricing and international taxes specific tools should be establish to facilitate selecting the taxpayers for the tax controls. Moreover the wider access to the benchmarking databases (Amadeus) is necessary.

NIK recommend to MoF taking actions to improve the efficiency of transfer pricing inspections carried out by the tax authorities as well as extending the compulsory information on related party transactions that should be reported by the taxpayers.

MoF announces the action plan against transfer pricing

In response to the NIK's Report, the MoF announced following initiatives aimed at improving the effectiveness of tax controls in the area of transfer pricing:

- developing detailed guidelines for the tax authorities regarding controls of the transactions conducted by related parties,
- developing a catalog of good practices in the field of risk analysis and control entities use transfer prices,
- organizing training courses and practical workshops on transfer pricing for employees of tax authorities,
- introduction of new control tools which will be used for selection of the taxpayers for audits,
- developing the IT tools and databases containing financial statements enabling verification of prices in controlled transactions.

Moreover, the MoF informed that the works on revising the transfer pricing documentation requirements has been already initiated to adapt the EU Code of Conduct and OECD BEPS project latest developments.

Actions taken by the NIK and the MoF indicate that in the near future taxpayers can expect intensified tax audits on transfer pricing.

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Turkey

The influence of European Law on Turkish transfer pricing case

Transfer Pricing in Turkey is regulated by Article 13 of Corporate Tax Code numbered 5520, published on 21 June 2006 and the provisions have been effective since January 2007. Since globalization has boosted the level of overseas trade and commercial transactions, transfer pricing is high on the agenda of Turkish Tax inspectors. Tax inspections and tax litigation in relation to cross border payments and transfer pricing in Turkey has immense increased to evade distortions of tax revenues. Tax inspectors have started to concentrate in transfer pricing inspection of especially the biggest risk group of multinationals, since they have diverse commercial and financial relations with their associated enterprises. On the other hand there is an optimistic progress in relation to transfer pricing cases. Turkey has applied European Court of Human Rights (ECHR) law in a transfer pricing case and referred to the right of equality of arms and the right to a fair trial.

The client in this transfer pricing case was operating a business concerning the importation and marketing of computers, supplying measurement systems and provided technical services as well. The tax inspectors alleged in their report; based on a benchmark study they have generated through information available only to themselves that the client had taken part in a disguised profit distribution, by purchasing computers and technological equip-

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ment from its overseas associated enterprise at a higher price than an arm's length transaction. The lawsuit was brought against the tax assessment and disputed that the use of a secret comparable during a tax audit is limiting the applicant's right to a fair trial and right to defence. The First Instance Court ruled that the tax assessments were not justified as they included a secret comparable and consequently amounted to the violation of the so called principle of equality of arms, which requires that each party must be given a reasonable opportunity to present their case under fair conditions.

ECHR case law is rarely used as a supportive component in Turkish courts. Generally, Turkish tax inspectors make their assessments based on their professional experiences and personal views on tax technique. However, the Turkish Tax Courts do not publish all court decisions, so it is not possible to confirm that this is the first time that the Court has implemented ECHR Law in a transfer pricing case. The ruling of the court may not amend the legislation, because the ruling is not binding other cases or current regulations. Still, the decision could force the tax authority to be careful by using hidden comparables in their practise. Nevertheless, the decision may also be used as an example for future tax court decisions and has opened a new door for Turkish tax professionals.

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United Kingdom

Diverted Profits Tax – A New Tax

The new diverted profits tax (DPT) is now in force and applies from 1 April 2015, at 25% on "taxable diverted profits" where there is an "avoided permanent establishment ("PE")" or a "lack of economic substance". This contrasts with the UK corporation tax rate of 20%.

It is helpful to understand that the amount initially charged may differ from the final liability. This is important because the obligation to pay cannot be postponed and HM Revenue and Customs (HMRC) have indicated that they anticipate using DPT as a tool to break any transfer pricing "impasse".

- **Notifications:** Diverted Profits Tax has a notification obligation and thereafter any liability depends on HMRC raising an assessment. There are exceptions to the duty to notify. Broadly, this is where there is no DPT (ignoring transfer pricing adjustments) or HMRC are sufficiently informed. The notification must be made within 3 months of the end of the relevant accounting period. However, there are transitional provisions that extend this to 6 months for the first period. Failure to notify extends the period during which HMRC can raise an assessment from 2 years to 4 years (after the relevant accounting period). There are tax geared penalties for failure to notify.
- **Core Tests:** There are 2 core tests, namely "The Avoided PE" and "Lack of Economic Substance". The two tests can overlap and it is not always clear which HMRC would regard as in point. Generally there is a participation requirement, which pulls in familiar transfer pricing concepts. There is also a "material provision" requirement.
- **Exemptions:** There are a number of exemptions within the regime such as limited UK-related sales (≤ £10m), limited UK-related expenses (≤ £1m), loan relationships, small or medium enterprises and payments to certain types of entity. However, particular care is necessary because they only apply to certain tests.

HMRC published detailed interim guidance on 30 March 2015 setting out commentary and including examples for the new tax. The DPT legislation is complex and the legislation and guidance extends to 120 pages.

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Ukraine

Special Transfer Pricing Rules for Commodities Trading with "Low-Tax" Jurisdictions

The new Ukrainian Transfer Pricing (TP) rules, effective from January 1, 2015, provide for the special Transfer Pricing Rules for Commodities Trading with the companies, registered in "Low-Tax" jurisdictions. These rules are probably the most heavily criticized innovation in this sphere so far.

According to section 39.2.1.3 of Art.39 of the Tax Code of Ukraine, the special rules are applicable to transactions:

(i) with non-residents, registered in the states from the "Low-Tax" states list adopted by the Cabinet of Ministers of Ukraine[1]; and

(ii) involving exportation or importation of commodities with quoted prices.

The comparable uncontrolled price (CUP) method should be used to determine whether the conditions of such transactions comply with the arm's length principle. When applying CUP the mean price of respective commodities according to the exchange quotations as per decade before the controlled transaction should be taken as the "most comparable price". The Cabinet of Ministers of Ukraine adopts the list of commodity exchanges, which are used for each group of goods subject to these rules.

There is an alternative option available for the taxpayers. In particular, the other TP methods may be applied. Yet, in this case, the taxpayer shall submit to the tax authority information about profit realized by each related party that participated in supply chain of respective commodities up to the first non-affiliated entity. This information should be submitted to the tax authority before 1 May of the year following the reporting year and disclose the profit indicators in line with the opted TP method.

Ukrainian fiscal authority has the right to determine the arm's length price following the CUP method if taxpayer fails to submit such information or the information is not sufficient to confirm compliance with the arm's length principle.

This new rules potentially cover the lion's share of Ukrainian commodity exports and pose serious questions to taxpayers which business is concerned. Thus, in mid-March the Cabinet of Ministers has released the draft Regulation on the list of exchanges and the commodities covered by these rules. Namely, these rules are expected to cover exports of grain, vegetable fats and oils, chemicals, fuels, ferrous metals etc. The list mentions such exchanges as Chicago Mercantile Exchange, New York Mercantile Exchange and London Commodity Exchange.

Taxpayers and experts hardly criticize these new TP rules. The principal arguments opposing these rules are as follows:

- Ukrainian exports are rarely comparable with the exchange quotations, especially at the commodity exchanges, as mentioned in the draft regulation of the Cabinet of Ministers;
- The Tax Code provides for the adjustment of the exchange quotations taking into consideration the volume of the controlled transaction and terms of settlements and supply,

1 The Cabinet of Ministers of Ukraine adopts the list of states based on the following three criteria:
1) states with corporate income tax rate lower than in Ukraine by 5 percentage points;
2) states that do not disclose the ownership structure;
3) states with which Ukraine does not have treaties with information exchange provisions

transport and other costs established in the contract. Yet, there are no clear rules following which such adjustment could be done. Practically, it would be difficult to ensure trustworthy adjustment with reasonable efforts.

- The Tax Code does not provide for the clear algorithm of computing the mean price of respective commodities according to the exchange quotations per decade, which is dogmatically stated as the "most comparable price" for respective commodity.
- The alternative option suggested in the Tax Code is hardly practical. It would be extremely difficult to collect necessary information within the set deadline considering standard deadlines for financial reporting. Moreover, the rule is written in the way that the tax authority has broad discretion whether to accept the information as sufficient.

We tend to conclude that there are fair grounds for the criticism. The suggested rules contain significant flaws that need to be resolved prior to the practical implementation.
A more straightforward question may be posed – what is the reason for introducing such special rules under the transfer pricing system, which principally follows OECD Guidelines? The existing rules provide for sufficient instruments in ensuring compliance with the arm's length principle. It is not in the nature of the liberal economy to set some artificial indicator, which should be taken as the "most comparable price". The fiscal authority might equally well have set that it is necessary to compute the profit tax liabilities by applying such indicator without hiding this administrative compulsion under the transfer pricing rhetoric.

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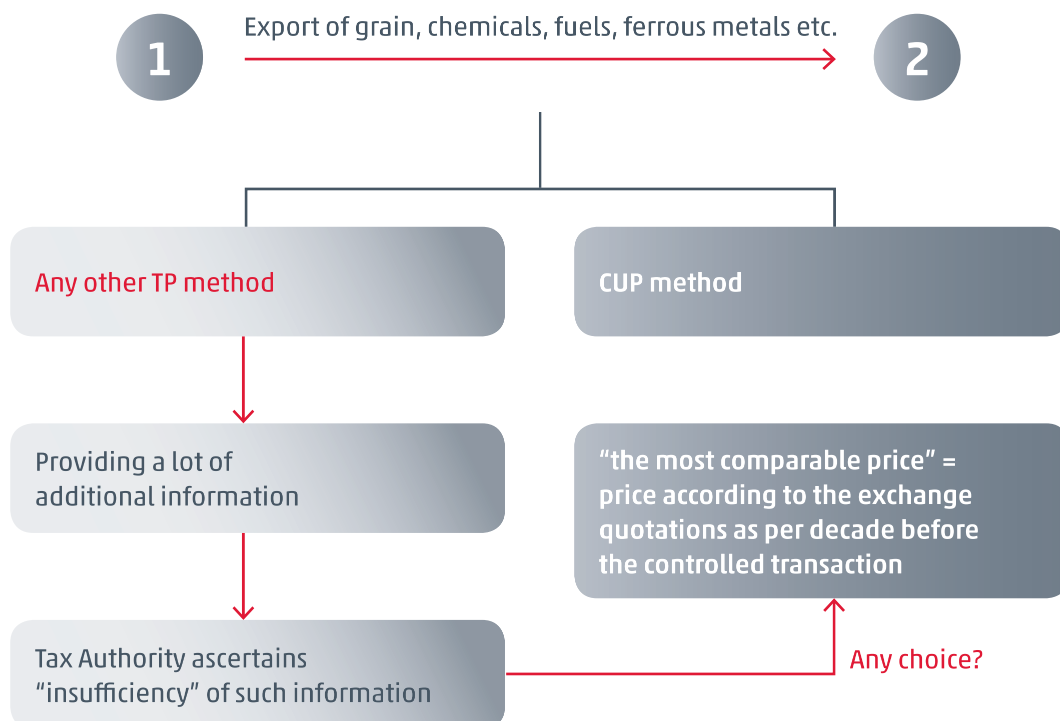

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United States

United States to Implement BEPS Country-by-Country Reporting Requirements

United States to Implement Country-by-Country Reporting, Despite Concerns

On February 26, 2015, a senior official in the U.S. Treasury Department's Office of International Counsel announced that the United States will implement a tax reporting requirement based on the Organization for Economic Cooperation and Development's ("OECD") country-by-country ("CbC") reporting template. The United States is expected to follow the OECD's recommended timeline, meaning that qualifying U.S. multinationals will be required to submit the template for tax years beginning on or after January 1, 2016.

The announcement was a significant development in light of previous concerns expressed by Internal Revenue Service ("IRS") officials that the CbC reporting template would be a significant administrative burden for taxpayers, and would be of little practical use to tax administrators. In addition, as recently as December 2014, IRS Commissioner John Koskinen indicated that the IRS does not presently have the information technology capabilities or human resources necessary to effectively review the expected influx of CbC data.

Despite the foregoing concerns, in an interview with Bloomberg BNA–published on December 9, 2014 (23 Transfer Pricing Report 1040)–Koskinen acknowledged that there is enough momentum and multilateral support within the international community that the adoption of the CbC reporting template by the OECD is inevitable.

OECD: Country-by-Country Reporting Initiative not Dependent on Comprehensive Adoption

The contemplated CbC reporting procedure is expected to be structured in a way that will require a qualifying taxpayer to submit a single global template to the tax administration in its country of incorporation. The information will then be shared through a formal government exchange process. The participation of major global economies, including the United States, would therefore seemingly be critical to the effectiveness of the CbC regime. However, in an OECD Base Erosion and Profit Shifting ("BEPS") update webcast on February 12, 2015, the Director of the Center for Tax Policy and Administration, Pascal Saint-Amans, clarified that there will be exceptions to these procedural requirements. If a given country does not adopt CbC reporting requirements, then tax administrations in foreign countries may request the CbC template directly from affiliated entities in their respective jurisdictions. Accordingly, qualifying U.S. multinationals would be required to comply with the OECD's CbC regime even if the United States had declined to participate in the program.

Turning Lemons into Lemonade?

Since the CbC announcement in February, the Treasury Department has remained largely silent on the issue. However, in an interview with Bloomberg BNA–published on April 15 (23 Transfer Pricing Report 1579)–senior Treasury Department officials, Robert Stack and Michael McDonald, signaled what could be a shift in the formal U.S. posture toward the CbC reporting requirements; providing a qualified, yet generally affirmative assessment of the initiative.

Speaking on behalf of the U.S. Treasury Department, McDonald suggested that the CbC requirements, as set forth in the September 16, 2014 guidance, strike an appropriate balance between transparency and compliance costs. By establishing a minimum revenue threshold

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of 750 million euros, the Treasury Department estimates that 90 percent of multinational enterprises will not be required to prepare a CbC reporting template.

One of the primary concerns that taxpayers and other stakeholders expressed in public comments to the OECD on the initial CbC draft report was that widespread sharing of sensitive company information could lead to data breaches—both unintentional and intentional. In addition, stakeholders questioned whether governments would limit their use of the CbC reporting template to its stated purpose as a risk assessment tool. Stack attempted to assuage these concerns by indicating first that the Treasury Department believes that countries understand their responsibility to maintain confidentiality and use the information for its intended purpose. He went on to emphasize that the U.S. "will be diligent to stop exchanging information with countries that don't do what they said they would do. To the extent countries misuse the information, or use it to do formulary apportionment, [the Internal Revenue Service] will have the right to stop sending the information."

Conclusion

The announcement that the United States will implement CbC reporting requirements is a significant step forward in the path to a Post-BEPS world—even if the OECD has ensured that it is little more than a symbolic gesture. Multinational enterprises headquartered in the United States should be keenly aware of the forthcoming reporting requirements and begin taking steps to prepare for the new CbC regime.

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