ANDERSEN

Global Transfer Pricing Insights

October 2021

Current state of transfer pricing administration, key issues, and what taxpayers can do to best safeguard their transfer pricing positions in each jurisdiction

Global TP Insights

Introduction

Transfer pricing enforcement activities around the world continue to intensify. In addition, the much-publicized efforts by the Group of Seven (G-7), the European Union (EU), and the Organization for Economic Co-operation and Development (OECD) threaten to revise the rules of international taxation rights to a degree not seen in the past century.

In short, taxpayers face the specter of new tax and transfer pricing rules that will further complicate an already complex landscape. Accordingly, taxpayers should not simply rely on past transfer pricing practices to inform how they establish, implement and defend positions in jurisdictions where they operate.

This inaugural edition of Andersen Global Transfer Pricing Insights is intended to help you navigate the rules, regulations, policies and practices in the covered jurisdictions. The insights that follow should not be regarded as an all-inclusive reference guide, but rather, as a practical guide highlighting some of the noteworthy transfer pricing trends and audit practices taking place around the world.

As always, the insights provided are subject to changes in laws or rules, as well as the overall business environment in each country. Please contact an Andersen advisor for a more detailed discussion of specific transfer pricing rules or to obtain further assistance with your intercompany transfer pricing issues.

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Africa Region

Transfer Pricing (TP) in recent times, has become a major tax consideration for multinational enterprises (MNEs) and domestic groups across Africa. ”

Joshua Bamfo - Managing Director/Partner
Andersen in Nigeria
Member Firm of Andersen Global

Introduction

Transfer Pricing (TP) in recent times, has become a major tax consideration for multinational enterprises (MNEs) and domestic groups across Africa. African countries have moved from a regime of general anti-avoidance provisions in their tax laws to introducing TP-specific legislation aimed at protecting their tax base and increasing their tax revenue. This section focuses on selected African countries, outlining the current state of the TP administration in each country, focus areas of tax/TP administrators during TP audit, and proactive measures taxpayers can adopt to manage TP risks that may arise during an audit.

Proactive Steps to Manage TP Risks

Despite the aggressive positions taken by tax authorities across various jurisdictions, taxpayers can manage their TP risks effectively and efficiently by paying attention to the areas listed below, amongst others:

- TP documentation: The TP documentation is the taxpayer's first line of defense in the case of a TP audit. Taxpayers are expected to disclose and analyze their related party transactions to reflect compliance with the *arm's length* principle in the TP documentation. It is important that the analysis and results in the TP documentation are sufficient to defend the *arm's length* nature of a taxpayer's related party transactions. Also, in preparing the TP documentation, a risk assessment should be conducted to identify possible high-risk areas and action steps that can be taken to manage such risks.

- Accurate TP disclosures: One of the TP obligations in most African countries is to make certain disclosures by completing and submitting statutory TP forms annually. This is one of the initial documents available to the tax authorities for the TP risk assessment of taxpayers. Thus, it is important that the TP forms are completed accurately to reflect the true state of the company's TP profile.

- Audit defense file: In addition to the TP documentation prepared, taxpayers should be proactive by developing an audit defense file which should contain all relevant supporting documents such as invoices, agreements, economic reports, etc. to support the *arm's length* nature of their related party transactions. In 2021, taxpayers whose Fiscal Year 2020 margins were negatively affected by the COVID-19 pandemic and had to adopt drastic measures to manage the impact, will be required to explain the reasons for the relatively low margins earned. It is imperative that this is done with sufficient documentary evidence.

- Advance Pricing Arrangements (APAs): In jurisdictions that have started implementing APAs provisions (e.g., Morocco), taxpayers can enter in APAs with the tax authorities with respect to their related party transactions. This will help provide certainty in the treatment of the related party transactions and significantly reduce the risk of an adjustment during an audit.

Overall, taxpayers in the Africa region need to be proactive in managing their TP risks by ensuring that the conducts of their related party transactions are consistent with the *arm's length* principle. To ascertain this, taxpayers should analyze all related party transactions from an *arm's length* perspective before entering into the transaction. Having a TP policy within the organization can aid to mitigate the risk of mispricing a related party transaction, especially for companies operating in jurisdictions that have recently introduced or revised TP legislation. ■

Cameroon

> The Finance Law 2012 focused on, among other things, the non-deduction of payments for corporate and income tax purposes made to countries deemed a tax haven and thereby set the tone for TP and anti-avoidance in the legislation. ”

Jude Muluh - Managing Director/Partner
Muluh & Partners
Collaborating Firm of Andersen Global

Current State of TP Administration and Focus Areas of Tax/TP Administrators

The first TP-specific legislation was introduced in the January 1, 2012 Finance Law (the Finance Law 2012). The Finance Law 2012 focused on, among other things, the non-deduction of payments for corporate and income tax purposes made to countries deemed a tax haven and thereby set the tone for TP and anti-avoidance in the legislation. The Law defines a tax haven as any territory where the corporate tax or marginal tax rate is less than 11.66% (a third of comparative corporate tax rates in Cameroon). Countries that qualify as non-cooperative for fiscal transparency and exchange of information purposes by international financial institutions also fall under this category.

The Finance Law 2012 was updated by Law No. 2014/026 of December 2014 which included an obligation to prepare and submit certain documentation to substantiate the transfer price. Prior to these legislations, anti-avoidance provisions existed in the Finance Law of 2007.

Further, Sec. 19 of the 2017 General Tax Code (GTC) discusses the application of the *arm's length* principle between related parties. Based on the provisions of Sec. 19, related companies must document the *arm's length* price, the method used for determining the *arm's length* price, and all evidence or documents supporting the controlled transactions. ■

Côte d'Ivoire

> In recent times, tax audits, which have resulted in significant adjustments, have been focused on subsidiaries and affiliates of MNEs.

Marcellin Zunon - Managing Director/Partner
Mondon Conseil International
Member Firm of Andersen Global

Current State of TP Administration and Focus Areas of Tax/TP Administrators

TP has been a viable solution for the Ivoirian Tax Authorities in increasing government revenue while protecting the country's tax base. In 2017, specific TP regulations were incorporated into the Ivorian tax legislation to align with the OECD TP Guidelines.
A major area that requires improvement relates to the TP dispute resolution mechanisms. The TP regulation does not include any Mutual Agreement Procedure (MAP) or APAs.

In recent times, tax audits, which have resulted in significant adjustments, have been focused on subsidiaries and affiliates of MNEs. Agriculture remains the greatest contributor to Côte d'Ivoire's economy, and multiple investment opportunities exist. This performance has enabled the country to become the world's largest producer of cocoa, cashew nuts, rubber and cola. Accordingly, local TP/tax administrators are also focused on the agro-industry sectors with divergent analysis and opinion on entities in the following areas:

- The determination of the *arm's length* price: From the tax perspective, the *arm's length* transfer prices are formed and obtained from the international commodities stock exchanges (LIFFE, SICOM, etc.). Tax administrators also refer to some external databases to determine the *arm's length* transfer price since they cannot access local public financial information to determine the tax adjustments.

- Pricing date for commodity priced by reference to quoted prices: Where the price for the sale of a commodity between the Ivorian entity and its related parties is determined by reference to the quoted price, a particularly relevant factor is the pricing date. Pricing date refers to the specific time, date or time period (for example, a specified range of dates over

which an average price is determined) selected by the related parties to determine the price for the commodity. However, the tax administrators cannot provide reliable evidence of the pricing date agreed in the related party commodity transaction at the time the transaction was entered into and its consistency with their actual conduct or with other facts of the case.

- Functional analysis: The functional profile of an entity for a related party commodity transaction is dependent on the nature of the commodity marketing/trading activities it performs (taking into account assets used and risks assumed) which in turn defines its contribution to value. However, the tax administrators are not able to perform such functional analysis and thus determine the tax adjustments as the difference between the price they consider to be the *arm's length* transfer price and the price from the related parties' contracts. ■

Ghana

> In order to align with the OECD TP Guidelines, Ghana recently enacted the Transfer Pricing Regulations of 2020 (L.I. 2412) to replace the Transfer Pricing Regulations of 2012 (L.I. 2188) which has been repealed.

Eric Mensah - Managing Director/Partner
Sam Okudzeto & Associates
Collaborating Firm of Andersen Global

Current State of TP Administration and Focus Areas of Tax/TP Administrators

TP regulations were first introduced in Ghana in 2012. In order to align with the OECD TP Guidelines, Ghana recently enacted the Transfer Pricing Regulations of 2020 (L.I. 2412) to replace the Transfer Pricing Regulations of 2012 (L.I. 2188) which has been repealed.

Despite the recent amendments in the legislative framework, the TP administration in Ghana is still at the developmental stage. However, there are steady advancements to ensure the capacity development of practitioners in this area.

In Ghana, presently, the TP focus for tax administrators includes:

- Reports that provide a functional and risk analysis for each transaction
- Adjustment to the limitations of the pricing rules
- Comparable data which reflects current economic conditions
- Financing transactions
- Intragroup support services

Morocco

The CGI provides that all related party transactions be conducted in a manner consistent with the *arm's length* principle.

Mehdi Al Attar - Managing Director/Partner
MA Global Consulting
Collaborating Firm of Andersen Global

Current State of TP Administration and Focus Areas of Tax/TP Administrators

TP rules in Morocco are contained in its tax laws (i.e., the Moroccan Tax Code or Code Général des Impôts/CGI), in particular Articles 213(II) and 214(III). The CGI provides that all related party transactions be conducted in a manner consistent with the *arm's length* principle. Following its adherence to the inclusive framework for the implementation of the OECD BEPS Project, Morocco has committed to implement Action 13 of this project relating to TP documentation. This is introduced in the Moroccan Finance Law 2019 effective from January 1, 2020.

Morocco has thus introduced the requirement for some companies to document their TP policy through the establishment of the following:

- Master file and local file (Sec. 214 of the General Tax Code): The Finance Law of 2021 plans to limit this requirement to taxpayers whose turnover or gross assets are equal to or higher than MAD 50 million.

  Despite the fact that the requirement for documentation of a master and local file was introduced by the finance law for the Fiscal Year 2019, it remains subject to the publication by regulation of an implementing decree detailing the content of the reports.

- Country-by-country report (Sec. 154 of the General Tax Code): The requirement for the CbCR is applicable for fiscal years beginning on or after January 1, 2021.

The TP related areas tax administrators pay attention to during tax audits are essentially the following:

- The substance of the transaction, especially when it comes to services or management fees (tax authorities do not accept the payment for fictitious services)
- Transactions with related parties located in tax havens or in jurisdictions with low tax rates
- Intellectual Property (IP) arrangements

Nigeria

> The regulations were revised in 2018 to introduce administrative penalties for non-compliance, among other revisions, revealing the Nigerian Tax Authority's aggressive stance in protecting the country's tax base and increasing compliance.

Joshua Bamfo - Managing Director/Partner
Andersen in Nigeria
Member Firm of Andersen Global

Current State of TP Administration and Focus Areas of Tax/TP Administrators

Nigeria first introduced TP-specific regulations in 2012. The regulations were revised in 2018 to introduce administrative penalties for non-compliance, among other revisions, revealing the Nigerian Tax Authority's aggressive stance in protecting the country's tax base and increasing compliance. The tax authority has also introduced several regulations aimed at increasing transparency in the activities of taxpayers and ensuring substance in transactions among related parties. These regulations include the Common Reporting Standard (CRS Regulations) and country-by-country reporting (CbCR). The Finance Act of 2019 also introduced thin capitalization rules.

In recent times, following the decline in Nigeria's revenue caused by the Coronavirus disease and the consequent decline in oil prices, the tax authority has been under pressure to meet the revenue shortfall.

Accordingly, the tax authority has embarked on several TP audits and issued letters levying penalties on taxpayers presumed to have erred in their compliance with the TP regulations. Also, the first TP court judgment in Nigeria was delivered in 2020 with the judgment in favor of the tax authority resulting in an additional tax liability of NGN 1.74 billion (USD $4.48 million) to the taxpayer.

In Nigeria, some of the audit issues that TP administrators focus on are as follows:

- Procurement arrangements: Entities with procurement arrangements where a foreign procurement entity purchases products from a third party and resells them to a related party in Nigeria are potential audit triggers. The tax authority tends to scrutinize such transactions to ensure that the arrangement does not result in a shift of profit to other jurisdictions. Similarly, the Central Bank of Nigeria (CBN) also issued a directive to restrict access to foreign exchange by

the local entity to make payments to such foreign procurement companies.

- Significant portion of revenue/cost attributable to related parties: Entities who have a substantial portion of their revenue or cost attributable to related party transactions are at risk of being under the radar of the tax authority. Especially, for entities who operate in industries classified as high volume low margin industries, a slight distortion in unit price can lead to significant distortion in the tax-paying status of such companies.

- Capital structure: Tax authorities also focus on capital structures with more debt than equity, especially when foreign-related entities provide the debt. Further, the Finance Act of 2019 limits interest payment to foreign-related entities to 30% of earnings before interest, tax, depreciation and amortization (EBITDA) in any given tax year. Unutilized interest expense can be carried forward for a maximum of five years.

- Tax-paying status: Entities no longer in a startup phase with substantially related party transactions but continue to accumulate losses thereby not paying taxes may be classified as high risk by the tax authorities. Taxpayers who pay lower taxes than that obtainable in their industry may also have their transactions with related parties scrutinized.

- Management services: The tax authority also scrutinizes management services received by Nigerian companies to ensure they pass the benefits test (i.e., whether independent parties in comparable circumstances would be willing to pay for similar services from other independent parties). The pricing of transactions involving management services is also a source of concern for the tax authorities.

- Transactions with entities in tax-friendly jurisdictions: Entities with significant transactions with entities located in tax-friendly jurisdictions are also under scrutiny. The tax authorities aim to identify letterbox entities with limited activities but receive significant payments from a Nigerian entity.

- Intangibles: The revised TP regulations in Nigeria have restricted the tax deductibility for payments for the license of intangibles to not exceed 5% of EBITDA. Further, the tax authorities scrutinize intangible transactions to determine which parties perform the development, enhancement, maintenance, protection and exploitation (DEMPE) functions and ensure that the Nigerian entity is being compensated for any function performed to enhance the intangible in its local market. ■

South Africa

> Transfer pricing is a key focus area of the South African Revenue Service (SARS), and detailed queries and audits are common.

Jackie Peart - Managing Director/Partner
Andersen in South Africa
Member Firm of Andersen Global

Current State of TP Administration and Focus Areas of Tax/TP Administrators

Current State of TP Administration

Transfer pricing is a key focus area of the South African Revenue Service (SARS), and detailed queries and audits are common. It is likely that any resource and capacity constraints that exist within SARS will be remedied in due course.

Clarity is still awaited on the tax treatment of thin capitalization (which forms part of South Africa's transfer pricing legislation). There is an interpretation note on thin capitalization, which is still in draft form. Formal guidance in this regard is necessary.

Focus Areas of Tax/TP Administrators

The following are the key issues that local TP/tax examiners are focusing on currently:

- Financial arrangements and thin capitalization
- IP arrangements
- Management/service fees and outsourcing arrangements

Proactive Steps to Manage TP Risks

The annual tax return asks the question as to whether the taxpayer has transfer pricing documentation in place which supports an *arm's length* outcome for the year of assessment. Where the total value (without set-off) of cross-border related party transactions exceeds ZAR 100 million and ZAR 5 million, the taxpayer has an obligation to prepare and submit transfer pricing documentation in the form of a master file and local file, respectively. The same requirements exist if the taxpayer is subject to country-by-country reporting (where the multinational group has a turnover in excess of ZAR 10 billion), even if the South African taxpayer's cross-border related party transactions are less than ZAR 100 million.

When determining whether the ZAR 100 million threshold has been reached, taxpayers must include the value of all cross-border related party sales, purchases, service fees paid or received, license or royalty fees paid or received, interest income or expenses, the capital value of any financial assistance, guarantees and dividends.

There is no requirement for transfer pricing documentation to be submitted where the above thresholds are not exceeded. However, it is highly recommended that transfer documentation be prepared and retained, because if this question in the tax return is answered in the negative, the risk of closer scrutiny by the SARS is increased. As a result, the taxpayer will immediately be viewed weaker when attempting to defend its *arm's length* pricing between connected group companies. Note that all questions in the transfer pricing section of the tax return must be answered in full.

A taxpayer's significant tax compliance burden must be actively managed and planned for. Country-by-country reporting was introduced effective January 1, 2016, and detailed record retention rules for transfer pricing were introduced effective October 1, 2016.

Transfer pricing record retention rules make the retention of transfer pricing information mandatory for taxpayers with foreign-related party transactions that exceed the ZAR 100 million threshold. In addition to the documentation described above that must be submitted, additional information is required to be retained, which includes invoices, agreements and other information. All documentation required to justify *arm's length* pricing must be readily available and kept up to date. Even taxpayers falling below these thresholds are required to retain some records to justify their *arm's length* pricing, and these must be made available within a timeframe provided by the SARS. ■

Zambia

> The Zambia Revenue Authority (ZRA) has the power to make necessary adjustments to controlled transactions for taxation purposes. ”

Mulenga Chiteba - Managing Director/Partner
Chibuye Chola - Associate
Mulenga Mundashi Legal Practitioners
Collaborating Firm of Andersen Global

Current State of TP Administration and Focus Areas of Tax/TP Administrators

TP provisions were first introduced in the Income Tax Act Chapter 453 of the Laws of Zambia (ITA) in 1999 and have been amended subsequently. The most recent amendments are included in the Income Tax (Transfer Pricing) (Amendment) Regulations of 2018 (TP Regulations).

Pursuant to Sec. 97A of the ITA, transactions entered into between controlled parties must reflect *arm's length* conditions. The Zambia Revenue Authority (ZRA) has the power to make necessary adjustments to controlled transactions for taxation purposes. The reported income will be adjusted so that the same is computed on an *arm's length* basis. There is a TP division of the ZRA that conducts audits of controlled transactions. The TP Regulations recognize the application of the OECD TP Guidelines as well as the United Nations Practical Manual on TP for Developing Countries (the UN Manual). Where there is a conflict between the TP Regulations, the OECD TP Guidelines, and the UN Manual, the TP Regulations will prevail. In addition to the aforementioned legislation, the ZRA issued Practice Note No. 2 of 2018 which lays out the Commissioner-General's interpretation of Sec. 97A of the ITA and the Regulations.

Pursuant to Regulation 21, persons participating in controlled transactions are required to prepare all documentation verifying that the conditions in their controlled transactions are consistent with the *arm's length* principle. This information is required to be

provided in the related party transactions schedule of their annual income tax return.

In the landmark case between Nestle Zambia Trading Limited (Nestle Zambia) and the Zambia Revenue Authority (ZRA) 2018/TAT/03/DT, an important consideration by the revenue authority was the profitability of Nestle Zambia. In a presentation made at the United Nations/African Tax Administration Forum workshop on TP in November 2016, the ZRA indicated that some of the common TP issues that arise during audits are the following:

- Sale/purchase of goods
- Management and consultancy services
- Financial transactions
- Royalties on the use of intangibles

In addition to the aforementioned, the following are examples of circumstances that are likely to trigger a TP audit in the key areas of management services, goods and financial assistance:

- Management services:
  - Management services provided from a low tax jurisdiction
  - Management services provided to a loss-making local company
  - Management fees based on the turnover of the local company
  - The percentage ratio of management fees to turnover is material
  - A fully-fledged local operation that does not require the provision of management services
  - Lack of evidentiary support of the provision or management services such as physical visits by the provider and invoices for the same
  - Lack of evidentiary benefit derived by the local company from the management services provided
  - Absence of evidence of the arrangements between the provider and recipient
- Goods:
  - Low gross margins in comparison to industry averages
  - Purchase of goods from low tax jurisdictions
  - Goods shipped from the supplier rather than from the related party vendor
  - Loss-making local company
  - Bulk of cost of sales made up of related party purchases
  - Absence of evidence of the arrangements between the vendor and purchaser
- Financial assistance:
  - Thinly capitalized local company
  - High rates of interest in comparison to the market standard
  - Financial assistance provided from a low tax jurisdiction
  - High guarantee fees as compared to the market
  - Absence of evidence of the arrangements between the lender and borrower ■

Zimbabwe

> Until January 1, 2016 when specific guidance was introduced, Zimbabwe's TP compliance requirement was limited to sections of the Income Tax Act that required that related party transactions comply with the *arm's length* principle. "

Pamela Gona-Chimwamurobe - Manager
ChimwaMurombe Legal Practice (Zenas)
Collaborating Firm of Andersen Global

Current State of TP Administration and Focus Areas of Tax/TP Administrators

Until January 1, 2016 when specific guidance was introduced, Zimbabwe's TP compliance requirement was limited to sections of the Income Tax Act that required that related party transactions comply with the *arm's length* principle. Sec. 98B as read with the 35th schedule of the Zimbabwe Income Tax Act (Chapter 23:06) requires all persons engaged in business transactions, operations or schemes with an associated person must report the taxable income consistent with the *arm's length* principle.

Zimbabwe endorsed the use of OECD TP Guidelines and the UN Manual as relevant sources of interpretation for the 35th Schedule of the Income Tax Act. The Zimbabwean TP legislation applies to cross-border and domestic intercompany transactions with related parties. The TP legislation also includes penalties for non-compliance as follows:

- 100% penalty of shortfall amount for a TP adjustment due to fraud or tax evasion
- 30% penalty of shortfall amount for a TP adjustment where a contemporaneous TP document does not exist
- 10% penalty of shortfall amount for a TP adjustment if TP document which complies with TP regulations exists

The Zimbabwean Government, under Statutory Instrument (SI) 109 of 2019, gazetted the income tax (transfer pricing documentation) regulations on May 10, 2019. The SI specified the TP documentation requirement.

Further, with effect from the tax year ended December 31, 2019, a separate TP tax return is required to be submitted to the Zimbabwe Revenue Authority (ZIMRA). Due to the COVID-19 pandemic, the submission deadline for taxpayers having a December 2019 year-end was extended to August 31,

2020. Taxpayers who failed to meet this deadline were required to seek an extension from ZIMRA.

The 35th Schedule to the Zimbabwean Income Tax Act requires every person who engages in transactions between associated parties to generate and maintain relevant TP documentation. This enables the Commissioner General to ascertain whether a transaction was conducted in accordance with the *arm`s length* principle.

It is expected that in 2021 tax administrators are going to be focused on reviewing compliance with the requirement for robust documentation. Taxpayers will be given seven days within which to submit detailed TP documentation to ZIMRA upon request.

Australia

> The Australian Taxation Office (ATO) is known for being one of the most advanced and aggressive tax authorities in the world when it comes to transfer pricing (TP). ”

Benedicte Olrik - Managing Director/Partner
A&A Tax Legal Consulting
Collaborating Firm of Andersen Global

1 What is the current state of TP administration in your local country?

The Australian Taxation Office (ATO) is known for being one of the most advanced and aggressive tax authorities in the world when it comes to transfer pricing (TP). Having a relatively high corporate tax rate of 30% for larger businesses has certainly added to ATO's motivation to scrutinize multinational enterprises (MNEs) for any potential tax avoidance behavior.

The ATO's transfer pricing documentation requirements and guidelines date back to the early 1990s and have over time developed into today's myriad of tax rulings, tax alerts, and practical guidelines. The essential Australian transfer pricing rules are found in subdivisions 815-B to 815-E of the Income Tax Assessment Act 1997 (ITAA), and Subdivision 284-E of the Tax Administration Act 1953 (TAA).

These apply on a self-assessment basis to legal entities, permanent establishments (PEs), partnerships and trusts. The transfer pricing legislation does not depend on the test of control or share ownership; it applies whether the parties are related or associated. The legislation brings the transfer pricing rules more closely in line with the provisions of the OECD Guidelines.

In particular, Subdivision 815-B aims to ensure that the profits taxed in Australia from cross-border conditions between entities reflect the contribution made to the profits by operations in Australia. Subdivision 815-B requires examination of the substance of the transactions and is to be interpreted consistently with the OECD Guidelines. The law allows the ATO to disregard or reconstruct transactions to conform to the economic substance.

There are also rules to cancel a tax benefit under the general anti-avoidance provision. Section 177CB of the Income Tax Assessment Act 1936 provides a framework for determining an alternative proposal that can be used to ascertain if there is a tax benefit. The rules also allow the transfer pricing rules to be applied where a taxpayer has received a withholding tax benefit as a result of an arrangement that is not at arm's length.

In terms of supporting a taxpayer's pricing position, the ATO's Taxation Ruling TR 2014/8 sets out what transfer pricing documentation a taxpayer should prepare to meet the ATO's requirements under Subdivision 284-E. TR 2014/8 sets out a *five step* documentation process for all taxpayers with international related party dealings (IRPDs) to follow when preparing transfer pricing documentation.

To ensure that penalties and adjustments are mitigated, taxpayers will have to self-assess their transfer pricing position, and it is the onus of the taxpayer to keep evidence of this position by preparing transfer pricing documentation in accordance with the Australian TP requirements on an annual basis.

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

Total IRPDs above AUD 2 million must be detailed on the International Dealings Schedule (IDS) which is submitted annually with the taxpayer's Income Tax Return (ITR). The IDS is a disclosure form of IRPDs and includes the countries of main trading partners, type of dealings, TP method used, and level of transfer pricing documentation prepared.

The ATO collects all the data from the IDS, with country-by-country reporting (CbCR) documents for significant global entities (SGEs) where relevant, into their databases. The ATO extracts data from the databases to plan and strategize for risk reviews where corresponding trends or low profits or others are found to be of interest to the ATO for further scrutiny.

As an example of these activities, the ATO has in recent years, although paused during most of 2020 due to the COVID-19 pandemic, commenced with Streamlined Assurance Reviews (SARs). The first SARs were targeting the top 1,000 MNEs in 2018, and the next SARs targeted the following top 5,000 MNEs.

The SARs we have seen have a high focus on the usual suspects of intangible property (IP), IP migration, finance arrangements, use of exotic instruments or cost-sharing arrangements, centralized services or services in general, deemed PEs, dealings with low tax jurisdictions and low profits or losses.

Some of the risk reviews have been streamlined, but most seemed more like ranging from mini to almost full-blown TP audits with very detailed and comprehensive information requests issued by the ATO and dragging out for years.

Although the ATO seems to be more lenient during 2020, where most of Australia was in strict lock-down due to the COVID-19 pandemic, we are already seeing the ATO resuming its risk review and audit activities in 2021. The ATO is expected to be even more assertive in its mission to minimize any tax avoidance and to assist the government to bring down its enormous debt caused by the lengthy lockdowns of the Australian economy.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Having high-quality contemporaneous transfer pricing documentation in place that evidence the actual commercial and financial relations and factual circumstances is the best *insurance policy* to defend a transfer pricing position in the event of a future ATO review or audit.

High-quality documentation does not mean to have a transfer pricing documentation report the size of a phone book or the tax legislation, but documentation that is cleverly tailored to the best solution to support the position that dealings between related parties are in accordance with the *arm's length* principle. To create such a solution,

we suggest starting with the design of the transfer pricing structure of the group.

The design will include the standard pillars (i.e., business description, details of the IRPDs, financial performance, industry or economy relevant factors, selection of TP method and benchmarking) required by the Australian TP documentation guidance and the OECD Guidelines. However, it is not recommended to rely on the traditional transfer pricing analysis alone, as the nature and quality of the surrounding commercial evidence of the transfer pricing position is crucial.

As an example of the point mentioned, the High Court of Australia denied the ATO to appeal Glencore's win from a transfer pricing court case settled in November 2020. The case was that the ATO argued that changes made to Glencore's intercompany pricing agreements aimed to reduce Australian profits and would not have been made by parties operating at *arm's length*. However, the court agreed with the taxpayer that the changes satisfied the transfer pricing provisions' requirements.

The win underlines the importance of the rules relating to the burden and onus of proof and how the court would agree with robust commercial analysis and reasoning behind the change to the intercompany pricing agreements although it decreased Australian profits.

Accordingly, developing a smart transfer pricing design that is a true reflection of the commercial and financial relations of the taxpayer's IRPDs and supported by robust transfer pricing and economic analysis is a solid safeguard to any ATO inquiry and future audits. ■

Bulgaria

> It is important to note that during the last few years, TP has become one of the priority topics of the Bulgarian Tax Administration. "

Nikol Nikolova - Manager
Kambourov & Partners
Collaborating Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Reference to the *Arm's Length* Principle:
Chapter IV, Article 15 of the Corporate Income Tax Act (transactions involving related persons) provides that where related persons carry out their commercial and financial relations under conditions, which affect the amount of taxable profits, differing from those between unrelated persons, the taxable profits shall be determined and subject to tax under those conditions which would have been made between unrelated persons. The above provision also applies to transfers between a permanent establishment of a foreign enterprise and the other parts of the same enterprise, which are situated outside the territory of the country, in accordance with the specificity of the business activity of the permanent establishment (Article 17 of the Corporate Income Tax Act). The *arm's length* principle equally applies to domestic and cross-border transactions. Par. 1, subpar. 8 of the Supplementary Provisions of the Tax and Social Insurance Procedure Code stipulates that *market price* shall be the amount, without the value-added tax and the excise duties, which shall be paid under the same conditions for identical or similar goods or service in a transaction between persons which are not related. Par. 1, subpar. 9 of the Supplementary Provisions of the Tax and Social Insurance Procedure Code stipulates that *transfer prices* shall be in place when in the commercial or financial relations between related persons conditions have been made or imposed, which differ from those, which would have been made between independent persons, and which affect the amount of their profits or income.

Reference to the OECD TPG:
The Bulgarian tax legislation does not refer to the OECD Transfer Pricing Guidelines (TPG). However, as pointed out in the Transfer Pricing Guidance (2008) issued by the National Revenue Agency, the OECD Transfer Pricing Guidelines are accepted as internationally recognized standards setting out the concepts and principles to

be used in the valuation for tax purposes of transactions between related parties. The principles and recommendations contained in the OECD TPG lay down the basis for the Bulgarian Regulation on the determination of the prices (Regulation H-9 of August 14, 2006).

New rules for mandatory transfer pricing documentation

Local file

Under the transfer pricing documentation rules, Bulgarian taxpayers which, as of December 31 of the previous year, exceed two out of the three following thresholds will be required to prepare a local file:

- Net book value of assets not exceeding BGN 38 million (approximately EUR 19 million)
- Net sales revenue not exceeding BGN 76 million (approximately EUR 39 million)
- The average number of personnel (workers) for the reporting period not exceeding 250 individuals

Entities that are not subject to corporate income tax or that are subject to *alternative taxes* as well as entities engaged in related-party transactions only within Bulgaria will also be exempt from the obligation to prepare a local file.

The local file will be required to be prepared each year for related-party transactions exceeding the following annual thresholds:

- BGN 400,000 for sales of goods
- BGN 200,000 for other transactions
- BGN 1 million loan principal
- BGN 50,000 interest and other amounts related to loan revenue or expenses

Master file

Taxpayers that are part of a multinational group of companies and that are required to prepare a local file must also have available a master file prepared by the ultimate parent company or another member of the group.

Due dates, other procedures

The due date for the preparation of the local file is aligned with the deadline for filing the annual corporate income tax return for the respective year. The due date for the master file is within 12 months after this period.

The local file and the master file will need to be updated on an annual basis. Benchmark studies can be updated, as a rule, every three years at a minimum, but the data on the identified comparable transactions and/or entities must be updated annually.

Transfer pricing documentation will not be submitted by taxpayers to the revenue authorities but is to be kept by the taxpayers and made available upon request during the course of a tax inspection or a tax audit. There are penalty provisions for a failure to present the transfer pricing documentation upon request and/or for presenting false or incomplete data.

2 Are there any key issues that local TP/Tax examiners are focused on in your jurisdiction?

It is important to note that during the last few years, TP has become one of the priority topics of the Bulgarian Tax Administration. Essentially, this legislative change is a natural extension of the mandatory country-by-country reporting of large groups, which was introduced three years ago. The focus now, however, is entirely local. Instead of providing information on how the group distributes its profits and resources worldwide, the local file must prove specifically that the profits in Bulgaria are correctly determined, to the extent related-party transactions are concerned.

Regarding the Bulgarian National Revenue Agency strategy, there is a consistent policy for the development of administrative capacity in the TP field, as well as a focus

on the TP practices and profitability of local taxpayers during tax reviews and audits.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

While the transfer pricing documentation rules require the preparation of the documentation by certain qualifying entities, the rules also indicate what the revenue authorities would expect from other taxpayers. Based on the existing tax law, all taxpayers have a general obligation to prove the *arm's length* nature of their transactions (which is accomplished through the preparation of transfer pricing documentation).

In recent years, the Bulgarian Revenue Authorities have been building an administrative and technical capacity and practice in the area of transfer pricing. It has been noted that there have been tax inspections that focus on transfer pricing, followed by material tax assessments from these transfer pricing audits. With transfer pricing identified as a top priority by the Bulgarian Revenue Authorities, even more increased scrutiny may be expected in the near future.

The preparation of transfer pricing documentation requires taxpayers to articulate convincing, consistent, and coherent transfer pricing positions that will be subject to a detailed functional and economic analysis – taking into consideration a number of factors such as the overall position of the entity within the taxpayer group's value chain, the business value drivers and the business cycle, the market, and the existing comparable data. The preparation of contemporaneous transfer pricing documentation is intended to confirm the integrity of the taxpayer's position and would demonstrate that the taxpayer has already analyzed the *arm's length* nature of its related-party transactions and, thus, the position it reports in its annual corporate income tax return. ■

Croatia

> The application of the *arm's length* principle between related parties in Croatia is prescribed by Article 13 of the Corporate Income Tax Law (CITL) and Article 40 of the CIT Ordinance.

Marko Kallay - Managing Director/Partner
Kallay & Partners Ltd.
Collaborating Firm of Andersen Global

1 What is the current state of TP administration in your local country?

The application of the *arm's length* principle between related parties in Croatia is prescribed by Article 13 of the Corporate Income Tax Law (CITL) and Article 40 of the CIT Ordinance. Even if there is no direct reference in Croatian legislation, in practice the Croatian Tax Administration uses the OECD Transfer Pricing Guidelines.

Transfer pricing documentation should present the *arm's length* principle of transactions between related parties, domestic and foreign alike, or two domestic parties if one of them is in a preferential tax position.

Article 13 of the CIT Act defines *related parties* as parties in which one entity participates directly or indirectly in the management, control, or capital of the other party, or the same persons participate directly or indirectly in the management, control, or capital of both parties.

Transfer pricing provisions in Croatia were introduced through the CITL on January 1, 2005, but only in recent years, the Croatian Tax Authorities have recognized the importance of transfer pricing, with Advance Pricing Agreements (APAs). The implementation of APAs in the national legislation of Croatia (CITL amendments - Official Gazette No. 115/16, Ordinance published on April 2017) reveals significant progress towards harmonizing the Croatian legislation with OECD Transfer Pricing Guidelines.

From January 1, 2017, entities must file an annual PD-IPO report (Report on Business Activities with Connected Parties) on related party transactions along with their corporate income tax return.

Taxpayers may request Mutual Agreement Procedure (MAP) assistance under the terms of the relevant DTA, EU Arbitration Convention and/or Council Directive.

Croatia is a signatory to the Multilateral Competent Authority Agreement (MCAA) on the exchange of country-by-country reports (CbCR), signed on July 6, 2017. The CbCR requirements are applicable to constituent entities of Croatian-resident MNE groups with consolidated revenue exceeding EUR 750 million.

Generally, the tax authorities accept regional benchmark studies, but it is recommended to submit local benchmarks, if possible. There is no requirement regarding the use of a certain database for performing searches for comparable. The Croatian Tax Authority (CTA) uses the Amadeus and Orbis database. CTA also uses publicly available databases.

There is no available public data in Croatia about court cases related to transfer pricing. Although some TP concepts in Croatia are relatively new, CTA audit has become more sophisticated and complex.

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

The CTA is regularly performing detailed transfer pricing audits, with the primary targets being large taxpayers. Other audit triggers, apart from the size, include a steep fall in profit, continuing losses, and companies that are part of multinational groups but special attention has been directed towards management fees and royalties charged between related parties and intragroup services transactions.

For taxpayers incurring losses or low profits, the tax authorities will analyze the reasons by focusing on TP, challenging the allocation of extraordinary losses, or arguing for higher profit allocation in the past or for future years in return for assuming additional risk.

Lack of supporting documentation and information, absence of economic substance

of the transaction, failure to comply with the formal requirements stated in the tax provisions, and lack of compliance with the *arm's length* principle for related parties transactions are the most important issues in the audit.

The tax authorities will not perform a transfer pricing adjustment after the APA conclusion (i.e., in the APA duration period, as long as the taxpayer fully complies with the terms of the APA, or until the conditions of the APA change).

It is difficult to fully predict the extent of the impact that COVID-19 will have on TP policies and perspectives. In 2020, and most likely in the following years, the economics of many companies will be negatively impacted by COVID-19, while the previous three years' (2017-2019) financials are not affected.

Normally, in the contest of TP economic analysis (for instance through a transactional net margin method or the TNMM method), a common method for testing an inter-company transaction in Fiscal Year 2020 would be looking at the average of the three previous years, assuming that the economic circumstances in the year under analysis are similar.

The adjustments can be made at any point, up to the deadline for submission of the tax return. After that filing date, a taxpayer may submit, within the period of three years, an amended tax return for the relevant fiscal period, which can be incorporated a change to any transfer pricing adjustment.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

It is recommendable to compile the transfer pricing documentation carefully and update it at least once a year. The documentation should be prepared by the date of filing the annual corporate income tax return (the deadline of which is four months after the last day of the business year, e.g., April 30 following the business year if the business year is the calendar year). Documentation should be made available immediately upon request.

It is necessary to:

- Provide a rigorous and complete analysis of the related party transactions
- Identify the chosen method(s), describe considered data, methods, and analysis, and explain the reasons for choosing a specific method
- Compose the documentation on assumptions and estimations brought on and made during the determination of the results of transfer prices (regarding the comparability analysis, functional and risk analysis)
- Compose the documentation about calculations made during application of the chosen method regarding the taxable person and taxable persons with which he is compared
- Update the documentation from the previous year which was used in this year's study, to show adjustments made because of material changes in relevant facts and circumstances
- Compose the documentation that states the base, or, in some other way supports or is mentioned through the transfer price study

Robust documentation does not simply mean being in a range. TP documentation should be transparent and aligned with tax authority expectations and the preventive measures will decrease audit risk exposure and defense costs.

If material differences between the tested party and the independent enterprises are affecting the net margins, reasonably accurate adjustments should be made to account for such differences. It can be justified by a company strategy of establishing low prices to enter a market and launch a new product, whether due to heavy start-up costs, unfavorable economic conditions, inefficiencies, or other legitimate business reasons. However, those low prices can only be applied for a limited period to increase profits in the long term. ■

Germany

> The legal basis for transfer pricing laws is, among others, the Model Tax Convention on Income and on Capital, Sec. 90 par. 2 and 3, Sec. 138a, 162 par. 3 and 4 of the General Tax Code.

Alessio Rossi - Managing Director/Partner
Andersen in Germany
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

For the first time, transfer pricing in Germany became a central topic due to a Federal Fiscal Court ruling in October 2001, in which the approach to prices between a foreign (Italian) parent company and a German distribution subsidiary were the focus of the entire procedure. This led to a number of significant legal changes in Germany as well as a large number of administrative regulations. The legal basis for transfer pricing laws is, among others, the Model Tax Convention on Income and on Capital, Sec. 90 par. 2 and 3, Sec. 138a, 162 par. 3 and 4 of the General Tax Code.

Current Actions of the Federal Ministry of Finance

On December 4, 2020, the Federal Ministry of Finance published new administrative policies (Administrative Policies 2020) for the examination of income allocation between related companies as well as the estimation of tax bases. These are to be applied by the financial administration with immediate effect. The Administrative Policies 2020 focus on issues relating to the application of Sec. 90 of the General Tax Code (obligations of the parties involved to cooperate) and Sec. 162 of the General Tax Code (estimation of bases of taxation). The Administrative Policies 2020 deals with the position of the tax administration on, among other things, the duties to cooperate in general, the principles of the duty to keep records regarding documents in foreign cases, and the requirements for the documentation of facts and adequacy.

Master File and Local File

The Administrative Policies 2020 considers the division of transfer pricing documentation into a master file and a local file, as reflected in Sec. 90 par. 3 of the General Tax Code.

Increased Duty of Cooperation

Taxpayers are subject to an increased duty of cooperation in the case of foreign tax matters Sec. 90 par. 2 of the General Tax Code.

The tax authority undertakes a significant extension of the evidence to be submitted. For example, the submission obligation now also extends to e-mails, messenger service messages, or messages via other electronic communication media, insofar as these contain tax-related content. The taxpayer must submit all of these as part of its records.

Conclusion

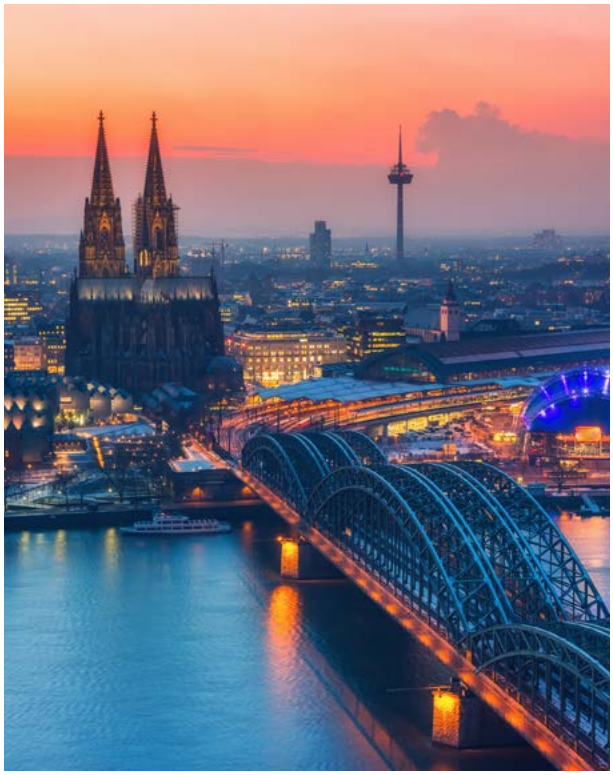
Taxpayers are strongly advised to follow the guidelines contained in the Administrative Policies 2020 in order to be best prepared for a future external audit.

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

Even though the Federal Ministry of Finance has been very restrained in the past year around transfer pricing (profit deferral between related parties and profit allocation to permanent establishments), the current developments as well as the practical implications are very diverse.

Implementation of Anti Tax Avoidance Directive (ATAD)

On March 24, 2020, the Federal Ministry of Finance published the draft bill of a law to implement the ATAD, which received extensive comments. The draft provides various changes in the area of Sec. 1 of the



Foreign Tax Law. The following aspects are highlighted by way of example:

- Emphasis on *actual circumstances* as the benchmark for determining the transfer price (Sec. 1 par. 3 of the Foreign Tax Law)
- Emphasis on functional and risk analysis as the basis for determining the *arm's length* price (Sec. 1 par. 3 of the Foreign Tax Law)
- Clarifying provisions on intra-group financing transactions (Sec. 1a of the Foreign Tax Law)

Current Case Law – Unsecured Loans

Important issues have also arisen in the current case law. According to the previous case law of the Federal Fiscal Court, loans between related companies were generally not subject to *arm's length* collateralization. This was based on the consideration that the lender has a special influence on the

affiliated borrower and therefore does not need to provide collateral to secure the loan claim.

With several recent decisions, the Federal Fiscal Court moved away from its previous case law. The court stated that collateralization is a typical characteristic of third-party loans. Therefore, an uncollateralized intercompany loan shall be considered as not being at *arm's length* since it lacks typical third-party characteristics.

COVID-19 Pandemic Implications

The past year has been clearly marked by COVID-19. This situation, which poses a major threat to the global economy, probably poses a challenge to all parties involved. The Federal Ministry of Finance did not seek a national, unilateral approach with regard to transfer pricing.

The main challenges in the respective areas are briefly noted below:

- Liquidity: securing short- and long-term liquidity requirements
- Operations: supply chain disruptions, downtime, capacity shifts, reduced demand and restricted movement of goods
- Employees: control functions
- Allocation pricing: forecasting calculations, design, ex-ante, interpretation of guidelines and impact on contract terms
- Legal: third-party market conduct, *force majeure*, and the invocation of contractual rights

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Duty of Cooperation

Compliance with increased duties to cooperate as described above.

Coordinated External Audit

In a letter dated January 6, 2017, the Federal Ministry of Finance commented on the implementation of coordinated bilateral and multilateral tax audits. The tax administrations of different countries are increasingly cooperating, especially in transfer pricing issues and permanent establishment profit sharing issues. The aim of coordinated external audits is to determine the facts relevant to the decision by mutual agreement.

The subsequent goal is to avoid international taxation conflicts and the resulting mutual agreement procedures. The coordinated tax audit can be the basis for the application for an Advance Pricing Agreement (APA) on the part of the taxpayer. If a legally binding agreement on the income tax assessment of the mutually agreed facts is sought with the tax administrations involved, a corresponding application by the taxpayer by way of a mutual agreement procedure is necessary.

Advance Pricing Agreement (APA)

The APA procedure is an agreement between one or more taxpayers and one or more tax administrations. It establishes an *arm's length* transfer pricing method for determining transfer prices in a certain period of time prior to the realization of business relations between related parties. The aim is to avoid disagreements between tax administrations of different countries regarding transfer pricing methods. Furthermore, an APA aims to avoid potential double taxation and to achieve legal certainty for the taxpayer and the respective tax administrations.

A request must be made for the APA procedure. The applicant is to be involved to a greater extent than in an ordinary mutual agreement procedure; in particular, the transfer pricing method to be proposed by the applicant requires intensive discussion. The tax authorities must consider all circumstances that become known in the APA procedure, both to the benefit and to the detriment of the taxpayer. ■

Hungary

> The regulation of transfer pricing in the Hungarian legislation was implemented around the turn of the millennium.

Sándor Hegedüs - Director
Andersen in Hungary
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

The regulation of transfer pricing in the Hungarian legislation was implemented around the turn of the millennium. The first related concept, the mention and definition of affiliated enterprises first appeared in the LXXXVI Act of 1991 on Corporate Income Tax on January 1, 1992. Since then, the term has evolved with the amendments of the Act. The *arm's length* principle was first described in 1999 in the XCI Act of 1990 on Tax Procedure. Failing to have transfer pricing documentation may result in the imposition of fines by the Hungarian Tax Authority (since 2004, based on XCII Act of 2003 on Tax Procedure).

The first decree concerning the rules of transfer pricing documentation came into effect in 2003, issued by the Ministry of Finance. Specifying the authorities' expectations of the documentation, the decree was amended twice in the last decades. The most recent amendment was made in 2017, which is still in effect today and lays out all the requirements for TP documentation, covering both local and master files. The decree serves as the baseline for all TP documentation created in Hungary.

As of January 1, 2021, the application of transfer pricing regulations is also included in the Act on Local Taxes and will have a more direct effect on the determination of the tax base of the local business tax in the case of affiliated enterprises.

A general increase in the importance of adequacy can be observed in the current state of the Hungarian TP administration. This is also reflected in the growing number of disputes litigated in Hungarian courts in the last few years. The most recent case litigated at the Supreme Court centered on the applicability of the transactional net margin method and shows that the Hungarian Tax Authority has been inspecting the adherence to specific regulations more rigorously.

The significance of TP examinations carried out by the Hungarian Tax Authority has also been growing rapidly. A central department dedicated to TP matters was established within the Hungarian Tax Authority, focusing on both theoretical and practical aspects of TP topics. A common practice followed by the authority is to involve its TP department even in general inspections, should a TP related issue arise and its complexity requires their involvement and expertise.

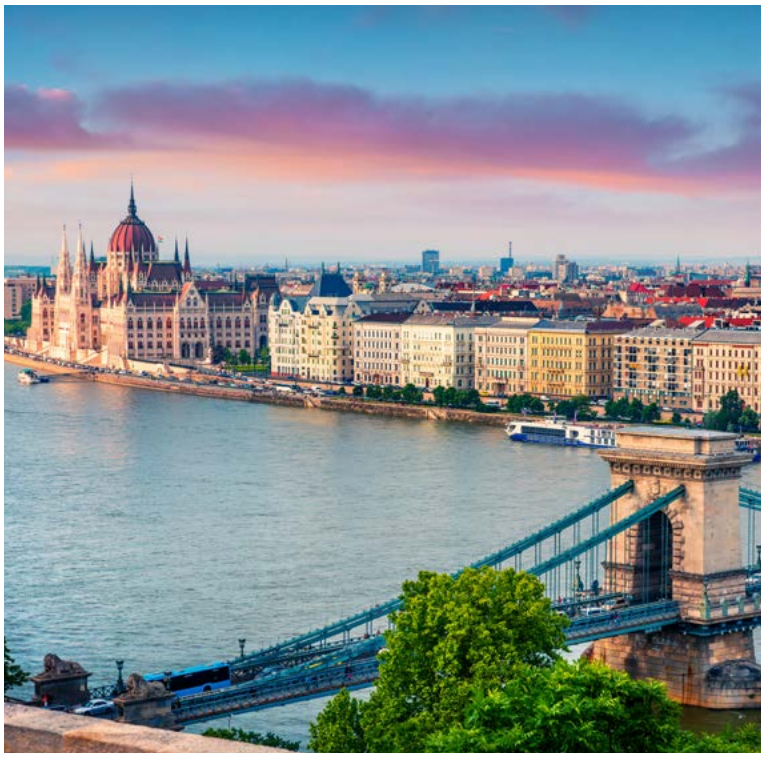
Lastly, a steady effort to centralize the transfer pricing-related matters can also be observed in Hungary. This extends to communicating a solid standpoint on TP related issues, providing consistent information, and, as mentioned, taking part in general inspections as well.

2 Are there any key issues that local TP/Tax examiners are focused on in your jurisdiction?

The evolution of the pandemic has resulted in several key issues arising with respect to transfer pricing. Apart from a few industries, the impact of the virus is devastating for many taxpayers, for whom suffering dramatic declines in profitability and becoming increasingly insolvent are common issues. Accordingly, the economic crisis brought on by the pandemic affects transfer pricing positions greatly.

The most recent publication of the Hungarian Tax Authority, which covers frequently asked questions (FAQ) about transfer pricing in light of the COVID-19 pandemic, was issued in September 2020. However, this publication is rather broad and only addresses some of the key aspects. The FAQ currently does not reflect the new OECD Guideline published on December 18, 2020 as the Hungarian Tax Authority has not implemented its recommendations in any way so far.

The measures taken by the Hungarian Government to mitigate the effects of the pandemic, however, will have to be taken into account with respect to transfer prices and the related documents regarding the years of the recession. Government-funded support concerning job retention, wage subsidies and investment aids are likely to have a serious impact on transfer pricing, as suggested by the OECD Guideline as well. Although an official guide has not been issued by the Hungarian Tax Authority yet, the recommendations outlined in the OECD document may be of great importance and will most likely be considered by the authority too.



As international examples suggest, providing sufficient support for benchmarking analyses will be one of the biggest issues to address in Hungary as well. There is also a possibility that the Hungarian Tax Authority will take a stricter approach in some of the issues outlined in the OECD Guideline, for which taxpayers should take the necessary precautions. For instance, up until now, the Hungarian Tax Authority has expressed a rather stringent opinion on the allocation of losses within group members to limited risk-bearing companies, declaring its legitimacy only in extremely well-grounded scenarios. The OECD Guideline is more permissive in this matter, seeing no problem in short-term allocation losses to limited risk group members, provided that the supporting facts justify the action.

Regarding the APAs currently in effect, the tax authority in Hungary has not provided an updated guidance yet. According to the FAQ published in 2020, the Hungarian Tax Authority stresses the need to reevaluate existing APAs and to determine whether the circumstances pertaining to them have changed substantially or not. The Hungarian Tax Authority provides consultancy in this respect to taxpayers, should they be uncertain about their positions.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Safeguarding taxpayers' TP position in case of an audit requires an expanded effort with respect to their transfer pricing documentation. On the tax authority's side, the demand for specific and detailed TP documentation is growing. However, overly general and broad documents are routinely flagged by the Hungarian Tax Authority for not being sufficiently detailed or trustworthy. To support this, the role of functional analysis in the documentation is gaining momentum and is confirmed by the existing guidelines of the Hungarian Tax Authority. Presenting the turbulence of

the affected economic environment should also represent a fundamental aspect of the transfer pricing documentation. Therefore, great effort should be made by taxpayers to meet the tax authority's expectation in this aspect.

The effects of the pandemic shall also be noted in this regard as well. During these turbulent economic circumstances, the verification of the transfer prices and achieving the required accuracy of the documentation altogether cannot be accomplished merely by following the best practices of earlier times. Rather, new practices must be established to meet the expected quality and reliability of the documentation.

Following the guidelines of the OECD, what should be tackled with high priority in Hungary is the provision of adequate comparability in the benchmarking studies. This will no doubt be a challenging issue due to its uncertainty and novelty, but the OECD Guideline's recommendations should serve as a practical starting-point for its implementation in Hungary. Therefore, in order for taxpayers to fully comply, it is advised to assess and report all the relevant information and data which reflect the impact of the pandemic.

In accordance with the standpoint of the Hungarian Tax Authority, all the relevant aspects that may influence transfer pricing must be taken into consideration and reported in the TP documents. Assessing the information should not be restricted to the taxpayer's business activity only, but should also concern the industry's profitability and, if possible, examine the comparables' circumstances. How the comparable entities survive during the pandemic, whether through increased or decreased profitability, may be a crucial factor when conducting a benchmarking study. Adding to this, the findings should also be presented in the transfer pricing documentation itself, not limited to the benchmarking analysis. As an example, the intensity of government subsidies discernible in the case of the taxpayer and also the comparables could potentially be relevant information for providing trustworthy comparability. On the other hand, in some cases, filtering out these pieces of information during the benchmarking analysis may be required in order to yield the necessary comparability.

As a takeaway, it must be noted that the currently observed best practice for taxpayers in Hungary preparing for a potential audit is to strive to accommodate the newfound circumstances as much as possible. This should not, however, influence the comparability, as the Hungarian Tax Authority will most likely expect the same quality from the documentation in the current times as well. Apart from including all the taxable components in the documents, as suggested earlier by the Hungarian Tax Authority, taxpayers should still focus on finding the most reliably comparable companies, preferably Hungarian entities, with the pandemic-related influences taken into consideration, depending on the individual case. ■

Ireland

"The new Irish transfer pricing rules effective from January 1, 2020 require careful consideration."

Mark Gorman - Managing Director/Partner
Andersen in Ireland
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Ireland's transfer pricing legislation is set out in Part 35A of the Taxes Consolidation Act (TCA) 1997 and applies the *arm's length* principle. In general, this means that transactions between related parties must be priced as if they were carried out between unrelated parties.

The *arm's length* principle is to be interpreted in accordance with the OECD Transfer Pricing Guidelines for multinational enterprises and tax administrations. Taxpayers can request competent authority assistance to resolve a dispute arising under a double taxation convention. The competent authority function seeks to resolve international transfer pricing disputes through negotiations with tax authorities of treaty partner jurisdictions.

Mutual Agreement Procedures (MAP)

The MAP is a means through which competent authorities consult to resolve disputes regarding the application of double taxation conventions. The MAP article in double taxation conventions allows competent authorities to interact with the intent to resolve international tax disputes. These disputes involve cases of double taxation where the same profits have been taxed in two jurisdictions.

The European Union (EU) Arbitration Convention establishes a procedure to resolve transfer pricing disputes for the EU Member States. This procedure may be applicable where double taxation occurs between enterprises of different EU Member States.

The EU Council Directive on tax dispute resolution mechanisms in the European Union provides a means to resolve cross-border tax disputes. This is given effect in Ireland by S.I. No. 306/2019. The regulations apply to disputes arising in respect of tax years commencing on or after January 1, 2018.

Ultimately, the objective of the MAP process is to both:

- Negotiate an *arm's length* position that is acceptable to both tax authorities
- Seek to avoid double taxation for taxpayers

Advance Pricing Agreement (APA)

In general, a bilateral APA is a binding agreement between two tax administrations and the taxpayers concerned. This is entered into by reference to the relevant double taxation convention. It governs the treatment for tax purposes of future transactions between associated taxpayers.

Essentially, the APA makes the tax treatment of relevant transactions clear for both the tax administrations and the taxpayers for the period covered. Effective from July 1, 2016, the Irish Revenue introduced a formal bilateral APA program. The introduction and publication by Revenue of this formal program provide clarity to taxpayers in respect of both:

- The process involved in applying for a bilateral APA
- The ongoing reporting and administrative requirements, once an APA has been agreed

Correlative Adjustment Claims

A correlative adjustment is an adjustment of profits under the terms of a Double Taxation Agreement which Ireland has entered into with another country. The purpose of a correlative adjustment is to provide a company with relief from double taxation.

Correlative adjustment cases arise where a company has accepted an adjustment that was raised by a foreign tax administration. The company must have paid the additional tax resulting from the adjustment. Companies resident for treaty purposes in Ireland may seek relief from double taxation arising in such cases. This is done by submitting a claim for a correlative adjustment to the Revenue.

Claims for a correlative adjustment must be made using the prescribed Form CA1. The guidelines for Article 9 Correlative Adjustment Claims contain information in relation to making a correlative adjustment claim.

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

Irish Revenue's main focus is on the areas of transfer pricing that were increased in scope on the introduction of Ireland's new TP rules, enacted by Finance Act 2019, took effect for accounting periods commencing on or after January 1, 2020. The principal aspects of the new Irish TP rules include:

- Adoption of the latest 2017 OECD Transfer Pricing Guidelines into law
- Specific legislative provisions that inter-company arrangements be priced based on the substance of the commercial or financial relations, where the form of the arrangement is inconsistent with the substance
- Providing the Irish Revenue with the explicit power, in certain narrow circumstances, to disregard the contractual form of an arrangement and replace it with an alternative arrangement that achieves a commercially rational result
- New TP documentation requirements which include an OECD master file and local file
- Extension of TP rules to *non-trading* transactions, subject to a domestic exemption in certain circumstances
- Extension of TP rules to capital transactions for the disposal of certain assets with a market value in excess of EUR 25 million
- Proposed extension of TP rules to SMEs pending a commencement order

- Removal of the legacy *grandfathering* provision which had historically excluded certain inter-company arrangements executed prior to July 1, 2010 from the scope of Irish TP rules

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

The best thing that taxpayers can do to best safeguard their TP position in case of a future audit is to seek advice early in the process. The new rules which took effect from January 1, 2020 are broad in range and with the assistance of Andersen in Ireland as well as member firms and collaborating firms of Andersen Global, taxpayers can be assured that they will be in the strongest position possible in terms of any future revenue audit from the Irish Revenue on a transfer pricing matter. ■

Italy

Not surprisingly, transfer pricing (TP) has gained increasing attention also in Italy in the last decade, and due to its subjective component, it has become one of the fields where major tax audits and tax controversy have arisen. ”

Stefano Rossi - Managing Director/Partner
Andersen in Italy
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Not surprisingly, transfer pricing (TP) has gained increasing attention also in Italy in the last decade, and due to its *subjective component*, it has become one of the fields where major tax audits and tax controversy have arisen.

After years of mismatching between the domestic transfer pricing guidelines and the OECD Transfer Pricing Guidelines (OECD TPG), Italy has finally endorsed the OECD TPG following the amendments set forth by Law Decree 50 of April 24, 2017 to Article 110(7) of the Italian Corporate Tax Act (CTA), and the related subsequent implementing regulations found in Ministerial Decree of May 14, 2018 (the Decree).

Also, the OECD TPG are mentioned as best practices in the implementation of the law provision regarding TP documentation requirements, as well as in the implementation of the law provision endorsing the APA program.

The above is corroborated by the fact that (among all) (i) the definition of the *arm's length* principle and the comparability analysis provided by the Decree is aligned to that outlined in Chapter III of the OECD TPG, (ii) remuneration should fall in the *arm's length* range of the selected profit level indicator (PLI) in order to apply the most appropriate method, resulting for the comparable companies, and (iii) simplified approach for low value-adding intra-group services, as described in BEPS Actions 8-10, will be accepted without thresholds.

Considering that prior to the publication of the Decree, domestic transfer pricing guidelines were included in Revenue Procedure No. 32/1980 – which was published right after the release of the OECD Transfer Pricing Guidelines in 1979 – and were still relied upon in transfer pricing audits until 2017, the Decree marked a

significant enhancement in the transfer pricing field in Italy.

The Italian legislation requires MNEs to prepare transfer pricing documentation regarding country-by-country report (CbCR) correspondent to Annex III of Chapter V of the OECD TPG, as set forth by Law No. 208/2015, Ministerial Decree dated February 23, 2017 and the Decision of the Commissioner of the Italian Revenue Agency dated November 28, 2017, which provides for detailed implementation guidance of CbCR.

However, the Italian legislation does not mandate MNEs to prepare a master file and a local file, which are optional. In case of an upward adjustment assessed by the tax authority subsequent to a TP audit, MNEs can claim the application of the *penalty protection regime*, provided that they comply with the Decision of the Commissioner of the Revenue Agency prot. 0360494 dated November 23rd, 2020: (i) filed proper TP documentation (master file and local file), (ii) opted-in to such regime via the check-the-box election in their timely-filed corporate income tax return, and (iii) digitally signed such documents with a timestamp by the time the relevant CIT return is submitted to the Tax Authority. Such regime allows the taxpayer to be relieved from TP-related penalties (which range from 90% to 180% of the assessed tax) insofar the Tax Authority has merits to raise the TP assessment.

On November 2020, the tax authority has provided updated guidance on such regime, which is now fully consistent with Annex I and II to Chapter V of the OECD TPG.

Furthermore, small and medium-sized enterprises (holding and sub-holding companies do not fall within this definition) opting for drafting the TP documentation can apply for a simplified approach: SMEs are entitled not to update the results of the comparability analysis for two fiscal periods following the period to which the documentation relates to, in case the comparability analysis is based on publicly available sources, and insofar as the comparability factors do not incur substantial changes during the above mentioned taxable periods.

When it comes to tax audits, MNEs should be aware that in Italy there are two different bodies that can conduct audits involving international tax and transfer pricing matters: the first – namely Agenzia delle Entrate (Tax Agency) – is an administrative body, while the second – namely Guardia di Finanza (Tax Police) – is a military body. They both belong and report to the Ministry of Economy and Finance.

Tax matters can be litigated before the Provincial Tax Court (first level), the Regional Tax Court (second level), and the Supreme Court (third level).

In case of primary adjustments notified by other countries leading to double taxation, taxpayers can request a unilateral corresponding adjustment to the Italian tax administration, which can be done not only in the execution of a Mutual Agreement Procedure but also upon formal request by the taxpayer. The Italian Tax Authority evaluates whether the primary adjustment made by the other country is in accordance with the *arm's length* principle, provided that a treaty against double taxation – allowing for an adequate exchange of information – is in force.

2 Are there any key issues that local TP/Tax examiners are focused on in your jurisdiction?

When it comes to auditing MNEs, tax examiners statistically tend to focus on (i) challenging transfer prices and entity characterization (remarkably, support sales services might be re-characterized as high-value-added services), (ii) detecting *hidden* permanent establishments, (iii) challenging tax residency status, (iv) assessing the correct application of tax treaties and EU directives (dividends, royalties and interests), and (v) assessing beneficial ownership status. Therefore international tax matters have to be seen in conjunction with transfer pricing and vice-versa, anytime.

It has to be noted that notwithstanding tax examiners will first look at formal aspects such as intragroup agreements, invoices and purchase orders, the ultimate goal will be to assess the substance of the commercial or financial relations and their *rationale*, as mandated by the BEPS project.

Tax examiners will look at structures where low functional/low-risk entities carry out operations in Italy and the value created is allocated in more favorable tax jurisdictions. In particular, Italian entities will most likely have to withstand the scrutiny of tax authority.

The use of intragroup intangibles by domestic entities has been a recurring item in tax audits where such intangibles were held in countries that historically have granted more favorable tax rates and/or treaty conditions to the recipient of royalties flows. An accurate analysis of the DEMPE functions together with a review of the entity's P&L and field interviews with key personnel will make it clear whether the domestic entity has the right to deduct any royalty. As a recurring approach, and still leveraging on the guidance provided in Revenue Procedure No. 32/80, royalty rates which are set above a *psychological* 5% rate on sales will require a robust benchmarking analysis, sound strategic grounds and industry analysis in order to corroborate such an expense incurred by the Italian entity.

Economic performance of domestic entities or branches constitutes an item which is highly scrutinized in Italy, so that those who show continuing loss positions, or steady low profitability (out of the market), would most likely face severe audits, with a hard burden of proof placed on the taxpayer.

When negative profitability is caused by transfer prices – depending on the characterization and functional profile of the entity/branch, and notwithstanding compliance with the ALP – the tax authority will investigate whether remuneration is in line with value creation and whether intragroup charges are not duplicative and they occurred as a response to specific and actual needs.

If economic performance and profitability have been affected by extraordinary

circumstances such as the COVID-19 Pandemic, the recently published guidance from the OECD should prevail and thus insulate taxpayers on aggressive tax/TP audits.

Negative compensating adjustments made on a lump sum basis at year-end will have most likely the same impact on tax examiners, at least *prima facie*.

Lastly, given a controversial approach which has been brought forward by the Supreme Court, non-interest-bearing intragroup loans lent by Italian entities or branches – although being absolutely legal from a civil law standpoint – would be challenged if notional interests are not calculated and taxed accordingly at the level of the Italian lender.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Intragroup transactions or business restructurings should pass a robust planning analysis (sanity-check) before they take place in order to withstand further scrutiny by tax examiners, and shall be addressed from multiple perspectives (legal, tax, financial, operational, organizational, etc.), being factored into a timeframe that should last beyond three years following the implementation.

Monitoring existing transfer pricing policies frequently (i.e., quarterly) helps taxpayers to timely detect any deviation that may occur to the planned intragroup transaction thus allowing for fast restoration of targeted transfer prices.

Assessing TP/tax risks and selecting the most appropriate/effective tool in order to manage and mitigate such risks: opting-in for the penalty protection regime constitutes a valid and cost-effective solution, while it also allows for protection not only from

administrative penalties but noteworthy, also from criminal offense ones which could arise out of a TP assessment.

However, it still does not address the concern of obtaining certainty regarding TP in terms of tax impacts and subsequent TP adjustments.

This can be achieved by *ex-ante* advance dispute resolution procedures such as the Advance Pricing Agreements (APAs), which have gained greater importance in the last two decades (the Italian APA program started in 2003) and constitutes a viable option to pursue such objectives for large MNEs, in particular by submitting applications for bilateral or multilateral APAs. The effects of the agreement can be applied retroactively (roll-back period) upon taxpayer's request, up to the fiscal year in which the Statute of limitation on assessments expires. This requires (i) the payment of a fee to the tax Authority for handling the procedure, (ii) that no tax audit has been initiated, (iii) facts and circumstances remain unchanged, and (iv) the agreement of the other tax authority(ies) involved in case of bilateral or multilateral procedures.

Statistics show that the latter take generally some years and are more expensive than the drafting of the TP documentation. However, they avoid wasting time and resources when a TP examination takes place. ■

Netherlands

> The documentation needs to be available within a reasonable timeframe when requested by tax authorities. ”

Boian Popov - Managing Director/Partner
Taxture
Collaborating Firm of Andersen Global

1 What is the current state of TP administration in your local country?

General transfer pricing regulations

The general transfer pricing documentation rules as incorporated in 2001 indicate that a taxpayer (through its administration) must demonstrate:

- How transfer prices (the pricing of transactions within a multinational group of companies, also known as intercompany transactions) have been established
- Whether the conditions under which these transfer prices have been concluded are in line with what would have been agreed between independent parties under similar circumstances (i.e., are at *arm's length*)

In this context, the legislator has specifically chosen not to maintain a minimum transaction volume. Hence, it must be clear for all intercompany transactions how the transfer prices were established, including the *arm's length* nature thereof.

Consolidated group revenue up to EUR 50 million

Although no specific formal requirements are imposed in Dutch law on the documentation requirement for multinational group companies with a consolidated turnover of up to EUR 50 million, in practice the *arm's length* nature of intercompany transactions must be substantiated.

For multinational companies with a consolidated group turnover of up to EUR 50 million, the transfer pricing documentation requirements can often be met by means of a memorandum. The documentation needs to be available within a reasonable timeframe when requested by tax authorities. This is typically between four to six weeks after receiving the request.

Consolidated group revenue between EUR 50 million and EUR 750 million

Starting 2016, additional transfer pricing documentation requirements have been imposed for Dutch taxpayers being part of a multinational group of companies with a

consolidated group turnover exceeding EUR 50 million. These taxpayers are obliged to document and substantiate their transfer pricing policy in two different reports, the so-called master file and local file. The master file and local file should meet specific requirements that are in line with international/OECD standards. The documentation must be included in the administration within the (regular) period for filing the corporate income tax return.

The master file contains information from the group as a whole and applies to all group companies. The local file provides additional information about the Dutch entities that are part of the group, including the intercompany transactions to which these entities are subject during the applicable fiscal year and the conclusion if these transactions were concluded at *arm's length*.

Consolidated group revenue exceeding EUR 750 million

In addition to the transfer pricing master file and local file mentioned in the section above, companies that are part of a group with a turnover exceeding EUR 750 million are also required to prepare and submit a country-by-country report to the tax authorities on an annual basis. This country-by-country report contains general information about all entities of the multinational group company and financial information split by country in which it operates.

Annual updates

Given that the preparation of transfer pricing documentation is part of annual administrative obligations as included in the Dutch General Tax Act, the documentation (i.e., a memorandum or master file and local file) must be updated on an annual basis.

In practice, this means that in the case of unchanged business operations, generally only the financial data and some parts of the general data must be updated.

The country-by-country report should be prepared annually and delivered within one year after the end of the financial year. In case the taxpayer does not file the country-country report in the Netherlands, the taxpayer should indicate which entity is submitting the country-by-country report and in which country this is done if it does not file the report itself.

Risks of non-compliance

If the required transfer pricing documentation is not correct, complete or presented (in time), the multinational company and its board members could (amongst others) be faced with the following risks:

- Tax audits and time-consuming discussions with tax authorities
- A correction of the taxable profit with reversal of the burden of proof and potential double taxation
- Penalties which, if imposed, are typically levied as a percentage of the additional tax that results from an adjustment
- Imprisonment of directors for a maximum of six years and fines ranging up to a maximum of EUR 87,000
- Failure to provide correct and/or complete country-by-country reporting (in case of group revenue exceeding EUR 750 million) shall be subject to a fine of up to EUR 870,000 for the taxable person and the above penalties and custody for board members

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

Tax audits in general are a regular occurrence in the Netherlands. In recent years, transfer pricing is likely a topic that is investigated in a tax audit of a multinational group. Specific transfer pricing audits also occur, albeit primarily with large multinational groups.

In the case of transfer pricing audits, the Dutch Tax Authorities are likely to closely examine (amongst others) the economic substance of transactions and alignment of functions and risks with the allocation of margins. Specific attention is often paid to activities performed and services provided by head offices. Additionally, the following key transfer pricing topics in the Netherlands are often the focus of an audit:

- Evaluation of intangible transactions
- Business restructurings
- Captive insurance companies

- Centralized purchasing companies
- Financial service transactions including intercompany loans and guarantees

As a final note, coming from the transfer pricing risk analysis, the Dutch Tax Authorities have shown a specific interest in intercompany transactions with affiliated enterprises in jurisdictions with a low effective tax rate.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

It is recommended for all multinational enterprises with a presence in the Netherlands to adequately document the applied transfer pricing policy in order to mitigate the risk of non-compliance with documentation requirements.

Another key point is to ensure that the transfer pricing documentation accurately reflects the factual situation of the business and the transactions under review. The availability of legal agreements covering intra-group transactions is important, together with an efficient operational transfer pricing system (i.e., making sure that day-to-day pricing results in the envisaged bottom-line allocation of margins).

Moreover, the Netherlands offers options to taxpayers to file for unilateral, bilateral and multilateral rulings (APA or Advance Pricing Agreement) in order to obtain certainty in advance.

A taxpayer is not eligible to file for certainty in advance if:

- It does not have sufficient relevant operational activities taking place in the Netherlands
- The sole or decisive reason for filing for certainty in advance is tax savings
- The transaction involves a non-cooperative or low tax jurisdiction

Furthermore, many jurisdictions have concluded tax conventions with the Netherlands. However, should double taxation nonetheless still occur, the respective countries can resolve this issue by invoking a Mutual Agreement Procedure (MAP) or arbitration if there is a legal basis for such procedure. Avoidance of penalties is important in this regard, as the imposition of penalties likely denies the taxpayer access to arbitration. ■

Poland

> Transfer pricing tax authorities in Poland have developed new solutions aimed at preventing tax avoidance and have also begun to use old instruments more effectively.

Arkadiusz Zurawicki - Managing Director/Partner
Andersen in Poland
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Transfer pricing tax authorities in Poland have developed new solutions aimed at preventing tax avoidance and have also begun to use old instruments more effectively. While some actions of Polish tax authorities may appear burdensome, there are positive initiatives aimed at developing dialogue and consensus between tax administration and taxpayers.

Transfer Pricing Return (TPR)

Since 2019, Polish taxpayers who are obligated to prepare the local file documentation have to submit a special transfer pricing return (TPR). TPR covers all transactions of a taxpayer that are subject to a TP local file documentation requirement. Taxpayers have to disclose in TPR a wide scope of information, including the details of the price calculation method and the presentation of the results of benchmarking studies in a structured and specified manner.

Transactions that are exempted from the obligation to prepare the local TP documentation, due to the fact that they are carried out between Polish companies, must fulfill some additional requirements, but the scope of data required to be disclosed is substantially limited.

It is very important to complete the TPR return correctly, as it was designed by the tax authorities as an automatic tool that will help to select taxpayers for audit proceedings. Should some discrepancies arise between the profitability or price in the controlled transaction and the results of the benchmarking studies, it may be worth considering adjusting the pricing in the transaction to avoid the risk of TP audit by tax authorities. It should be noted, however, that TP adjustments are regulated by specific provisions introduced in Poland as of 2019 and their implementation requires meeting certain conditions.

Additionally, taxpayers are obliged to submit the statement confirming the preparation of

the TP documentation and confirming that the prices in the controlled transactions were set at *arm's length*. The latter is particularly worth noting since providing an untrue statement may lead to punitive fiscal repercussions to the taxpayer's representatives. Making such a statement may be particularly problematic in case some free-of-charge controlled transactions (e.g., financial guarantees) took place in a given tax year.

Transfer Pricing Forum at the Ministry of Finance

The Transfer Pricing Forum (Forum) at the Polish Ministry of Finance was created in April 2018. It is a platform for cooperation and exchange of opinions between the tax administration and taxpayers (business representatives and transfer pricing advisors).

The members of the Forum are divided into working teams, which prepare recommendations, opinions, analyses and proposals aimed at simplification and improvement of the transfer pricing system in Poland.

Until January 2021, the Forum organized 10 sessions and published 13 recommendations, which gave taxpayers practical suggestions to fulfilling TP obligations. In addition, the recommendations of the Forum are taken into account by the Ministry of Finance in the process of issuing binding tax explanations. Such explanations give taxpayers the same level of safety as individual tax rulings.

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

Business restructurings

The tax authorities are currently focused on challenging business restructurings, both from the perspective of the TP regulations, and general anti-avoidance rules (GAAR).

Tax authorities examine whether transactions are carried out with the sole purpose of achieving tax gains and do not have any commercial justification (if a particular activity has no commercial justification, it is assumed that the principal or one of the principal objectives of the transaction is tax evasion or tax avoidance). As a consequence, tax authorities may disregard the tax effects of such transactions. Furthermore, a breach of GAAR may be potentially subject to punitive fiscal proceedings.

Moreover, the issue of compensation for the restructuring is also carefully analyzed from the TP perspective (if it was paid, in what form and if the value was *arm's length*).

It is important to note that GAAR became effective in Poland as of July 15, 2016, but for the first few years, it was almost never used by the tax authorities. However, between June 2020 and October 2020, 20 proceedings have been finalized, and 12 companies had to pay PLN 82 million of additional tax (cumulatively). Thus, GAAR seems to have evolved to become an essential instrument of the Polish tax authorities in assisting their fight against tax evasion.

Taxation of free-of-charge benefits

The value of goods received completely or partly free-of-charge is recognized as taxable income for CIT purposes in Poland. Because of the special interaction between said provisions and TP regulations, taxpayers may face very adverse consequences.

For instance, in the case of services provided free-of-charge, a service recipient should declare the value of services as taxable income. Furthermore, if such services are provided between related parties, tax authorities may adjust the income of the service provider based on the TP regulations and impose a penalty tax rate (which in total creates an effect of multiple taxations on the same funds).

The possibility of simultaneous assessments of taxable income in such cases was directly confirmed by court rulings (e.g., the judgment of the District Administrative Court in Warsaw on December 14, 2016, case No. III SA/Wa 2900/15, which concerned waived interest on the intercompany loan). In this case, the Court stated that the taxation of income of the lender resulting from the assessment of waived interest based on the TP regulations and recognition of taxable income for the borrower may occur at the same time, as the taxation concerns two different entities and is based on the different legal basis.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Robust TP documentation (contemporaneous)

In general, robust TP documentation prepared before or at the time the transaction is concluded is essential. Sound tax planning helps avoid future problems with proving the *arm's length* nature of the transaction, filing the TPR return, or making year-end TP adjustments if needed.

Defense file for business restructuring transactions

As Polish tax authorities focus more on business restructuring transactions, it is particularly important to prove their business rationale. This can be achieved by preparing a defense file, which would show realistic business goals (other than tax optimization) which the taxpayer planned to reach through the restructuring, as well as justification for the value of compensation made.

DEMPE analysis for transfer of intangibles

Another important consideration for business restructurings that involve transfers of intangibles is a DEMPE analysis (i.e., analysis of intangible development, enhancement, maintenance, protection, and exploitation activities).

In this regard, Polish TP auditors increasingly make use of the OECD Transfer Pricing Guidelines, especially in terms of identifying intangibles that may seem unnoticeable but are seen to have significant profit potential. Therefore, it is crucial to analyze DEMPE functions before any transfer of intangibles is made. ■

Portugal

> This has naturally led to a greater response as well as tax inspection capacity to the Portuguese companies in terms of TP. ”

Gonçalo Cid - Managing Director/Partner
Andersen in Portugal
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Regarding the Portuguese Tax Authorities (PTA), there has been an increase in their capacity of both technical and human resources when it comes to the Transfer Pricing (TP) area. This has naturally led to a greater response as well as tax inspection capacity to the Portuguese companies in terms of TP.

As such, unsubstantiated claims, statements or assertions often seen in TP reports (e.g., in the functional analysis section) shall not suffice anymore and are not expected to be accepted at face value without further supporting evidence.

2 Are there any key issues that local TP/Tax examiners are focused on in your jurisdiction?

From a Portuguese point of view, it should be noted that, in general, there is no focus area regarding TP inspections.

However, the following areas/transactions are usually subject to analysis by the PTA:

- Operational losses
- Cash pooling arrangements and financial operations
- Business restructuring and the valuation and transfer of intangibles
- Intra-group services and management fees
- Cost sharing agreements
- Operations with entities resident in the so-called *tax havens*

In addition, the PTAs are increasingly requiring taxpayers to provide respective TP files, justification for the TP methods chosen, and

other specific features regarding economic analysis carried out by the taxpayers, such as the choice of comparable data or profitability indicators.

In the context of tax inspection, the PTAs have the right to unrestricted access to the taxpayer's facilities in order to examine, reproduce and seize files, to obtain or consult any other relevant information regarding TP or the definition of contractual terms and conditions between resident or non-resident companies.

It should also be pointed out that, apart from a tax inspection, there is no other formal process to negotiate with the PTA in terms of TP.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

In addition to the usual TP compliance files, taxpayers must also ensure that such files are properly substantiated from a quality point of view.

Moreover, and considering the impact caused by COVID-19 on the transactions between related parties, it is particularly advisable for Portuguese taxpayers to:

- Properly analyze, quantify and document the effects of the pandemic on their TP policies, in particular regarding the allocation of losses and costs among group entities
- Adjust their economic analyses in the light of current circumstances
- Review their intra-group contracts and adjust their actions accordingly
- Verify whether there are substantial changes in the critical assumptions of their Advance Pricing Agreements and if so, contact their tax authorities ■

Romania

> Since the introduction of the *arm's length* principle in the national legislation, transfer pricing has become one of the highest priority areas the Romanian Tax Authorities confront during tax audits of multinational groups of companies.

Narcisa Ichim - Director
Țuca Zbârcea & Asociații Tax
Collaborating Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Since the introduction of the *arm's length* principle in the national legislation, transfer pricing has become one of the highest priority areas the Romanian Tax Authorities confront during tax audits of multinational groups of companies.

Although the introduction of the principle in the legislation dates back to 1994, tax audits on the matter only started to be performed after 2008, when Order No. 222/2008 of the President of the National Agency for Fiscal Administration (NAFA) was published. That order sets detailed requirements related to the preparation and content of the local transfer pricing file.

Since then, the replacement of the aforementioned act, with Order No. 442/2016, is a significant development in terms of the national legislative environment. The new enactment, valid since 2016, is still applicable and more closely aligns the local requirements with the approach of the OECD.

The *arm's length* principle applies in Romania to all transactions carried out between related parties, including those taking place between a non-resident legal entity and its Romanian permanent establishment.

Starting with 2010, related party transactions carried out between two Romanian legal entities also fall within the scope of transfer pricing regulations, whereas previously only transactions with non-resident related parties were investigated by the Romanian Tax Authorities.

Although Romania is not an OECD member, the national legislation expressly stipulates that within the application of transfer pricing rules, the OECD Transfer Pricing Guidelines will also be considered.

Starting in 2016, large taxpayers with intra-group transactions higher than specific thresholds have the obligation to prepare the annual local transfer pricing file.

Country-by-country reporting (CbCR) requirements are applicable to Romanian companies that are part of multinational groups with consolidated revenue exceeding EUR 750 million.

Taxpayers may request Mutual Agreement Procedure (MAP) assistance based on the provisions of the EU Arbitration Convention, the Council Directive, and based on the relevant Double Taxation Avoidance Treaty. Based on the latest statistics available, starting in 2017, the Romanian Tax Authorities closed 10 transfer pricing-related MAP cases.

The Romanian legislative framework provides the possibility to apply for unilateral or bilateral/multilateral Advance Pricing Agreements (APAs).

In recent years, we have witnessed an increasing trend in terms of the complexity of transfer pricing audits. The audits are carried out by tax inspectors within NAFA, who often receive support from the specialists under the Transfer Pricing department.

Currently, the transfer pricing file is requested in the vast majority of tax audits carried out by the Romanian Tax Authorities at the level of taxpayers that perform intra-group transactions.

Specific risk analyses are carried out for transfer pricing purposes and the certain situation surrounding intra-group transactions are usually closely scrutinized by the Romanian Tax Authorities.

Although the transfer pricing audits are becoming more sophisticated, the amount of publicly available data on transfer pricing-related court cases is limited.

2 Are there any key issues that local TP/Tax examiners are focused on in your jurisdiction?

The development of the key issues with focus from the Romanian Tax Authorities was influenced in the past years by the expansion of the local economy and also by the trends set by the international tax environment.

During tax audits, the Romanian Tax Authorities would examine both the formal aspects surrounding the transactions under analysis, such as agreements, invoices, or other supporting documents, and also their substance from an economic perspective.

Together with topics such as transactions without an economic substance, *hidden* permanent establishments, the applicability of VAT exemption for intra-community supplies of goods and for exports, and the deductibility of expenses related to intra-group services, the examiners perform in-depth analyses of specific transfer pricing issues.

One transfer pricing topic with significant scrutiny is represented by the remuneration related to intra-group services received by a Romanian taxpayer from a foreign-related party. Significant attention is given to intra-group management services. Besides the benefits test, the main aspects analyzed are related to the cost elements included in the base and the allocation keys applied by the provider. Benchmark studies prepared considering specific local requirements are necessary to support the level of the actual profit level registered by the provider.

Another category of topics frequently analyzed from a transfer pricing perspective is related to the position of Romania as a capital-importing country.

In this context, captive software development companies are required to support the *arm's length* nature of the pricing methodologies applied for services, which are in most cases provided only to foreign related parties. The actual operating margin registered by the Romanian taxpayer is usually under focus. A level of profitability of 5% or lower for software development activities is usually not accepted (unless

strong supporting evidence is provided in the local transfer pricing file), as this value is expected to reflect the *arm's length* nature of low-value adding services.

Companies performing activities under a limited functional profile, such as contract or toll manufacturers, limited risk distributors or shared services centers are expected to register consistent levels of operating profits. Operating losses or high fluctuance of the operating result trigger red flags and are highly scrutinized during transfer pricing audits. Deviations need to be supported with detailed fact-based arguments.

In addition to the specific cases above, the Romanian transfer pricing legislation contains particular requirements related to the preparation of the comparability analysis (for example, in terms of region of incorporation of comparables, independence), which prevail over the OECD standard approach and which are carefully verified by the tax authorities. The lack of compliance would trigger the comparability studies to be denied by the Romanian examiners.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

A prerequisite for taxpayers to safeguard their TP position in case of future audits is to prepare the local transfer pricing file.

We recommend to all categories of taxpayers with significant intra-group transactions to consider preparing the contemporaneous documentation before submitting the annual corporate income tax return. In case deviations from the *arm's length* principle are identified during the process, compensating transfer pricing adjustments may be considered.

Although the content of the transfer pricing documentation required by the Romanian legislation generally follows the OECD approach, as previously mentioned, specific requirements are in place and they should be considered in order to ensure compliance.

It is well known that transfer pricing analyses are usually prepared based on historical financial data. Thus, documenting the transfer prices applied during 2020 will certainly be a challenge. The documentation strategies approached so far will need to be reconfigured to account for the potential consequences of the COVID-19 crisis.

In going further, the safest measure that taxpayers can take to safeguard their transfer pricing position for future intra-group transactions is to apply for an APA.

In respect of APAs in force in 2020 or in course of negotiation, the new economic context brings the need to assess the extent to which such agreements are influenced by the current economic conditions and what are the potential actions needed to be taken in this regard. ■

Slovenia

> The latest changes of transfer pricing rules were made in 2016 by implementing the rules for country-by-country reporting and Advance Pricing Agreement (APA). ”

Lucijan Klemenčič - Director
Janja Ovsenik - Managing Director/Partner
Law Firm Senica
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

The Slovenian transfer pricing documentation requirements were introduced in January 2005. The latest changes of transfer pricing rules were made in 2016 by implementing the rules for country-by-country reporting and Advance Pricing Agreement (APA).

Slovenian transfer pricing regulations follow the principles of the OECD Transfer Pricing Guidelines and the recommendations of the EU Joint TP Forum. The Transfer pricing documentation is mandatory and should be submitted on request, otherwise, penalties may be levied. The Slovenian transfer pricing documentation requirements are based on a master file concept. Under this concept, as recommended by the European Community (EC) Council, as well as the European Union (EU) Joint Transfer Pricing Forum, the transfer pricing documentation should consist of a master file and a country-specific file. Transfer pricing disclosure which is part of corporate income tax return is also mandatory, in addition to transfer pricing documentation. Following the implementation of country-by-country reporting rules in 2016, relevant multinational entities which meet certain conditions are required to file country-by-country reports or notifications to the tax authorities.

The Slovenian regulation on transfer prices introduced the so-called *best method rule* in 2012. Adoption of the *most appropriate method* standard for the choice of transfer pricing method replaced the previous

hierarchy that preferred traditional transactional methods over transactional profit methods. However, to some degree, the hierarchy principle between the transactional profit methods and the traditional transaction methods still exists when both can be applied in an *equally reliable* manner, the traditional transaction method should be selected. There is a similar conclusion regarding the application of the Comparable Uncontrolled Price Method (CUP), which will trump any other method if both, it and the other method, can be applied in an *equally reliable* manner.

Transfer pricing rules prior to 2007 required the use of an average, as a measure of central tendency, in a sample of comparable transactions. This was intended to establish the *arm's length* nature of any given transaction. This so-called *single-point approach* was, however, abolished in January 2007. Acceptance of the inter-quartile range and the median as a measure of central tendency has since aligned the Slovenian transfer pricing rules with international practice.

Where the controlled transactions do not differ significantly, the taxpayer may provide transfer pricing documentation for a group of transactions. However, appropriate adjustments still need to be made with respect to any differences which may exist between transactions considered. All controlled transactions should be documented, without any simplifications for transactions of smaller amounts and without consideration to an entity's size.

The responsibility for TP examinations of transfer pricing has been centralized and

transferred to the main financial administration's office as of January 1, 2014. The department for transfer pricing operates within the tax examinations sector. This allowed for a greater specialization of tax inspectors, which are generally technically well versed in transfer pricing and communicate also in foreign languages.

TP examinations are a common type of tax examination in Slovenia. The number of examinations per year varies and seems to move around 70 per year, mainly due to the limitation of tax inspectors' number. So far, they have raised up to EUR 30 million of additional tax per year.

In addition to performing examinations, the activities of inspectors in the transfer pricing department are also aimed at preventive action. Thus, they have been approaching newly registered international companies with questionnaires since 2009. In this procedure, the inspector collects initial information on transfer pricing from the company and makes a visit to the taxpayer in order to inform them about Slovenian legislation in the field of transfer pricing.

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

A practical approach to finding solutions is essential in transfer pricing examination procedures, where intensive cooperation between taxpayers or their representatives and the tax inspector is required.

The Slovenian tax administration performs targeted examinations of transfer pricing. They make informative visits to newly registered international companies and branches. Taxpayers are thus increasingly aware that the tax administration monitors their business.

In recent years, the most common irregularities in the field of transfer pricing examinations referred to irregularities in respect of:

- Inappropriate use of transfer pricing methods and remuneration in the light of established facts and circumstances
- Interest deduction and thin capitalization
- Attribution of profits to permanent establishments
- Payments for the use of intangible assets

- Compensating adjustments where taxpayers inappropriately reduced their tax basis
- Services between related parties
- Routine functional and risk profiles of taxpayers and tax losses carried forward

Tax examinations are expected to focus on risky areas in the future, aimed at detecting and reducing tax and customs evasion and promoting voluntary disclosures.

According to the Financial Administration of Slovenia, it is expected that the largest share of tax examination will be carried out in the field of Value Added Tax, followed by corporate income tax examinations, taxes and social security contributions from personal taxation and other duties. More complex and major tax evasions will still be addressed in the context of financial investigations performed by the National Bureau of Investigation.

An important part of corporate income tax examination is transfer pricing. Examinations are generally focused on taxpayers who fall under a higher risk profile. It covers mainly taxpayers with a larger volume of controlled transactions and taxpayers who seem to report a relatively low tax base.

The COVID-19 pandemic and the disruption it brought to the global economy is the current issue. The financial administration has discussed this issue publicly from a transfer pricing perspective and they are aware that some industries have suffered more than others. It seems likely they will take this into account in their analysis. There is however no official position or guidance on how this would affect the comparability analysis. It remains to be addressed on a case-by-case basis.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

The current trend of increased transfer pricing scrutiny indicates the need for having a proper framework for identification, quantification and mitigation of transfer pricing risk.

It is very important that companies prepare proper documentation proving their claims and most importantly that both, taxpayers and tax inspectors find common ground on how to apply the *arm's length* principle. The financial administration themselves generally strives for higher efficiency and wants to reduce the number of time-consuming taxpayer complaints and resolve the matters during the examination.

All this re-emphasizes the importance of maintaining robust documentation to substantiate the company's transfer pricing policy and accordingly the remuneration model followed.

Tax authorities also promote APA to safeguard transfer pricing position. ■

Spain

> During the 2020 financial year, due to the lack of resources and the COVID-19 effects, it has been identified a slowdown in the completion of these processes.

Rafael Leal Benavent - Director
Andersen in Spain
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

According to the latest published activity report, the Spanish Tax Authorities (STAs) have identified transfer pricing as a priority area, focusing their activity, among others, on the Advance Pricing Agreements (APA), Mutual Agreement Procedure (MAP) and audit procedures.

APA/MAP:
In relation to APAs, the administration seeks to reduce litigation and improve legal certainty for the taxpayer. The STAs have participated in 220 APA files (20% more than the previous year), having finalized 66, of which 25 were accepted. Regarding MAP, the STAs participated in 380 procedures regarding direct taxation matters. During the 2020 financial year, due to the lack of resources and the COVID-19 effects, it has been identified a slowdown in the completion of these processes.

Audit procedures:
Transfer pricing audit procedures are coordinated by the local territory delegations and the central delegation (with the support of the ONFI – specialized international tax and transfer pricing administrative office). There has been a large increase in the number of audit procedures where the main focus is the treatment of related party transactions (the following section includes the main areas of review). It is important to highlight that during the year 2020, the tax administration implemented a new automated transfer pricing risk analysis system based on the entire set of information available on related party transactions (specific TP forms, CIT/VAT forms, APA, MAP, CBC, etc.). This new automated system allows the administration to identify situations where there could be tax base erosion or *profit shifting*.

2 Are there any key issues that local TP/Tax examiners are focused on in your jurisdiction?

The latest STAs annual tax and customs control plan (resolution of January 21, 2020) determines transfer pricing as a priority for audit procedures.

Mainly, audit actions will be focused on the following areas/targets:

- Compliance with transfer pricing documentation and information obligations (Articles 13 et seq. from the Corporate Income Tax regulation, CIT), without prejudice to the substantial analysis of the valuation of functions, assets and risks contained in such documentation
- Corporate restructurings
- Intragroup asset transfers, with special attention to intangible assets
- Tax deduction of those – intragroup originated – expenses that would significantly erode the tax base, such as royalty payments or intragroup services
- Intragroup transactions that would impact Spanish group subsidiaries with repeated losses over the years
- The activities carried out by group entities with functional structures with declared low business risk and a significant presence in the economy, both in the manufacturing and distribution areas, and the appropriate choice and application of the 18.4 CIT Law valuation methods in these scenarios
- Highly digitalized business models (it is expected that the administration will use the information obtained through forms associated with the Digital Services Tax on revenues resulting in the provision of certain digital services)
- Permanent establishments (detection of undeclared permanent and, in those declared, special attention to the correct attribution of results in order to avoid situations of minimum taxation not in accordance with current legislation)

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Besides complying with all formal/material requirements incorporated in our CIT Law and Regulations, we would highly recommend a review of the intra-group policies to be carried out based on the comparability/economic analysis of the transactions. In addition, given the new system used by the STAs for the identification of transfer pricing risks, we recommend reviewing the consistency of all the information provided (i.e., TP forms vs. VAT forms), as inconsistencies could drive a potential audit and with it, unwanted reallocations of group income. ■

Switzerland

Switzerland has no specific transfer pricing regulations but adheres to the OECD Transfer Pricing Guidelines. ”

Christian Crivelli - Managing Director/Partner
Lisa Airoldi - Managing Director/Partner
Andersen in Switzerland
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Switzerland has no specific transfer pricing regulations but adheres to the OECD Transfer Pricing Guidelines.

Implied *Arm's Length* Principle
Swiss tax law includes no specific reference to transfer pricing as well as no general, explicit definition of *related parties* or of the *arm's length* principle and its application to related party transactions.

However, legal support for adjusting a taxpayer's taxable profits on an *arm's length* basis is derived from Article 58, Paragraph 1 of the Federal Direct Tax Act (FDTA) and Article 24, Paragraph 1 of the Federal Tax Harmonization Act (FTHA).

These provisions require among others the following to be included in the taxable income:

- Not commercially justifiable expenditures
- Hidden profit distributions
- Revenues not credited to the profit and loss account

In addition, both federal acts include provisions on the thin capitalization rules (Article 65 of the FDTA resp. Articles 24, Paragraphs 1 and 29a of the FTHA).

Therefore, Swiss tax authorities assess intra-group transactions based on the *arm's length* principle. Intra-group transactions can include loans, license agreements, commercial transactions and more.

In the case of transactions between related parties, if a Swiss company is not adequately remunerated for its services, the Swiss tax authorities would consider the shift of profits as a hidden profit distribution. When this is the case, the taxable income of the Swiss company is increased by the amount of the hidden profit distribution and subject to income tax (federal, cantonal and communal income tax). Furthermore, hidden profit distributions are regularly subject to the Swiss withholding tax of 35% pursuant to Article 4, Paragraph 1 of the Withholding Tax Law.

In addition to the laws mentioned above, the Federal Act on the international automatic exchange of country-by-country reports by multinational enterprises (CbC Act) and the respective ordinance entered into force in December 2017. Except for the CbC Act, no formal transfer pricing documentation is mandatory in Switzerland.

Case Law

Of fundamental importance are the decisions of the Swiss Federal Supreme Court, which is the highest federal court in Switzerland. The definition of a related party is indeed derived from the Federal Court case law.

In principle, if a close commercial or personal relationship exists between two entities or individuals, these parties can be considered related. Direct or indirect participation in the management, control or capital is not required. The crucial question is if the tested transaction was conducted only as a consequence of the associated relationship or not. Furthermore, according to the Federal Court, the provision of services

under unusual terms or conditions which are not in line with the market can represent evidence for a relationship between the parties. (*note 1)

The Federal Court, in a number of decisions also established that the OECD Guidelines shall be used to determine whether an adjustment of the taxpayer's taxable income according to Article 58 of the FDTA is required. (*note 2)

Relevant SFTA Circular Letters

From a practical point of view, in 1997, the Swiss Federal Tax Administration (SFTA) requested the Cantonal Tax Administrations to take into account the OECD Transfer Pricing Guidelines when taxing multinationals enterprises.

Subsequently, the SFTA issued a series of circular letters referring to the *arm's-length* principle:

- Circular Letter No. 4 (March 2004) – Taxation of service companies
  The mark-ups of service companies have to be determined in accordance with the *arm's length* principle.

- Circular Letter No. 49 (July 2020) – Evidence of economic justification of costs in foreign-to-foreign transactions
  This circular specifies that:

  - Expenses must be commercially justified and documented.
  - Costs incurred for the benefit of shareholders and related parties must be comparable to those of third parties. In this regard, reference is made to Switzerland's commitment to applying the dealing at *arm's length* principle in accordance with the OECD Guidelines of 2017.

In two other SFTA circular letters, the reference to the *arm's length* principle is less explicit although the result is essentially the same.

- Circular Letter No. 6 (June 1997) – Thin capitalization rules (hidden equity)
  Swiss thin capitalization rules help to differentiate between debt and equity for tax purposes. This circular letter defines the maximal debt allowed on the basis of the fair market value of the underlying assets. If the liabilities exceed the permissible debt, hidden equity is assumed. However, only loans from related parties (or third-party debts secured by related parties) can be qualified as hidden equity for tax purposes. In addition, interest owed on hidden equity is not deductible from taxable income and is subject to Swiss withholding tax.

  As a result, in cases of hidden equity, there are usually corporate income tax, capital tax, and withholding tax implications.

  It should be noted that the circular letter also gives the possibility to the taxpayer to prove that a higher debt financing is at *arm's length*.

- Circular letters published yearly – Safe harbor interest rates
  The SFTA publishes yearly circular letters with safe harbor interest rates applicable to loans (denominated in CHF and in

Notes:

(1) Sentence 2C_177/2016 of January 30, 2017

(2) Sentence 2C_1073/2018, 2C_1089 of December 20, 2019; Sentence 2C_11/2018 of December 10, 2018; Sentence 2C_343/2019 of September 27, 2019

foreign currencies) received from or granted to related parties.

If a higher interest is paid or a lower interest is received, the difference between this amount and the safe harbor interest rate is generally qualified as a hidden profit distribution not deductible from taxable income and subject to Swiss withholding tax.

However, different interest rates can be applied if the taxpayer can prove that the financing structure is at *arm's length*.

These circular letters are particularly interesting if placed in the context of the *Transfer Pricing Guidance on Financial Transactions* released by the OECD in February 2020.

Digital Economy

In spite of strong reservations and in order to allow the project to proceed, Switzerland will adhere to the principles published on July 1, 2021 by the OECD Inclusive Framework concerning the future taxation of internationally active large companies.

The new rules are based on two pillars:

Pillar One

Transfer of taxing rights to market jurisdictions. The announced limits (annual turnover over EUR 20 billion; profit margin over 10%) should affect a limited number of companies in Switzerland.

Pillar Two

A minimum tax rate of 15% is envisaged for companies with an annual turnover in excess of EUR 750 million. There are around 200 companies in Switzerland above this threshold, as well as numerous Swiss subsidiaries of foreign groups.

However, approval will be subject to certain conditions. The new rules should:

- Take into account the interests of small and innovative countries
- Respect national legislative processes
- Be applied uniformly in all member countries
- Establish, with regard to the minimum tax rate, an appropriate balance between the tax rate and the calculation base

BEPS Initiative

Switzerland has joined and actively contributes to the BEPS initiative. It agrees that it is necessary to counter base erosion and profit shifting at a multinational level.

The abolition of the Swiss privileged tax regimes of the holding, domiciliary and mixed company as well as of the administrative practices on Swiss finance branches and principal companies is closely based on BEPS Action 5. This is a central part of the Swiss tax reform entered into force in 2020. Switzerland has adopted various measures with the aim of replacing the abolition of the privileged tax regimes while maintaining the attractiveness of Switzerland as a business location.

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

Case law in Switzerland has been particularly fertile on the subject of hidden profit distribution.

Hidden profit distribution is determined when:

- The company receives no consideration or adequate consideration for a benefit provided (i.e., the disproportion between performance and consideration).
- The shareholder or a related party is the beneficiary.
- The benefit would not have been granted on the same terms to a third party (i.e., the benefit is unusual).
- The disproportion between performance and consideration was recognizable for the corporate bodies.

Tax authorities are increasingly confronted with the problem of hidden profit distributions in the context of transfer pricing. This has essentially led the tax authorities to deepen their analysis of the functions and risks assumed by associated companies.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

As mentioned above, Switzerland does not require formal transfer pricing documentation except for the CbCR.

Taking into account the latest decisions of the Federal Court, master and local files implementation is anticipated and their preparation is highly recommended: the availability of documentation proving the adequate pricing of the intra-group transactions puts the taxpayer in a stronger position in case of disputes with the tax authorities.

The taxpayer must always be able to demonstrate that the controlled transactions carried out are at *arm's length* regardless of their materiality.

The taxpayer must cooperate with the tax authorities providing the necessary information, particularly where transactions are carried out from Switzerland to jurisdictions with which no double taxation agreement is in force or where the exchange of information does not meet current OECD standards. ■

Ukraine

> Starting from that time, the tax authorities' special department specializing in the conduction of tax audits of the compliance with the TP rules was created. "

Svitlana Musienko - Managing Director/Partner
Sayenko Kharenko
Collaborating Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Ukrainian TP rules were developed based on OECD Transfer Pricing Guidelines and introduced in Ukraine in 2013. Starting from that time, the tax authorities' special department specializing in the conduction of tax audits of the compliance with the TP rules was created.

Before 2019, court jurisprudence on TP matters was mainly focused on technical and procedural issues, such as disputes as to the compliance with terms for TP reports, the correctness of a form of TP reports, the provision of access to an office for the tax authorities in order to conduct tax audits of the compliance with the TP rules, etc.

Starting from 2019, the tax authorities apply more elaborate approaches during tax audits and focus on whether a TP method was properly applied to confirm compliance with the *arm's length* principle, whether the date of a transaction was properly determined (including in case of forward contracts), whether the period for the calculation of profitability was properly chosen, whether the profitability was calculated properly (if this is the case the tax authorities analyze the formula used and its elements), whether a tested party was properly determined (if a transactional net margin method or TNMM is applied), whether the information used to apply a comparable uncontrolled price (CUP) method is objective and reliable, etc. Currently, 84% of cases have been found in favor of taxpayers.

On January 16, 2020, the Law of Ukraine No.466-IX, introducing certain provisions of the Action Plan on BEPS into the Tax Code of Ukraine (the Law), was adopted. The core changes in TP are the implementation of a three-tiered approach to TP documentation: a local file, a master file (it should be

submitted in case an international group's revenue exceeds EUR 50 million), and a country-by-country report (for groups having a total consolidated group revenue of more than EUR 750 million during the fiscal year preceding the reporting fiscal year).

The requirement to submit a country-by-country report applies to the financial year ending in 2021, but not earlier than the year in which the competent authorities joined the multilateral agreement on the automatic exchange of interstate reports (Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports). At this stage, there is no clarity as to when the Ukrainian Authorities expect to join this agreement.

Also, the law introduces a requirement for taxpayers to submit a notification of participation in an international group of companies.

2 Are there any key issues that local TP/Tax examiners are focused on in your jurisdiction?

In Ukraine, the tax authorities in most cases apply a fiscal approach during tax audits. For example, the tax authorities ignore the presumption against the retrospective effect of the laws and apply TP rules in such a manner that could confirm their conclusions (in other words, the tax authorities tend to ignore that starting from September 2013, TP rules in Ukraine were restated at least several times).

However, the tax authorities also try to analyze the substance of TP rules and apply the OECD Transfer Pricing Guidelines. In particular, in individual tax rulings, the tax authorities refer to the OECD Transfer Pricing Guidelines while interpreting TP ruled provided for under the Tax Code of Ukraine.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Taxpayers should be aware that most of the tax authority's requests for TP documentation result in tax audits and court cases. Also, most of the evidence is provided to courts by taxpayers. As a rule, the tax authorities rely on a single document – a tax audit report, that is used by the tax authorities as an alternative TP documentation report versus a TP documentation report prepared by a taxpayer. In rare cases, the tax authorities also provide to courts the information received from foreign tax authorities on special requests, as well as refer to detailed calculations made during tax audits. In practice, in TP court cases, taxpayers use all possible supporting facts and evidence, including primary (source) documents, calculations, information used to prepare TP reports, expert reports, testimonial evidence, relevant publicly available information, etc.

Therefore, taxpayers should ensure that they have a properly prepared TP documentation report, an available defense file and documents that could be used as pieces of evidence in courts.

However, currently, the jurisprudence of the Ukrainian courts in TP cases is in development. Thus, taxpayers should monitor new cases and approaches employed by the tax authorities in order to prepare arguments/documents that could be used in case of tax audits in advance. Such an approach allows taxpayers to appeal tax audit reports immediately following the tax audits in administrative proceedings and to prevent court cases (where it is possible). ■

United Kingdom

> Transfer pricing is an area that UK's tax authority (HMRC) takes very seriously and has been a growing area of focus in recent years as HMRC has more than doubled the size of its transfer pricing resources.

Zoe Wyatt - Managing Director/Partner
Andersen in United Kingdom
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Transfer pricing is an area that UK's tax authority (HMRC) takes very seriously and has been a growing area of focus in recent years as HMRC has more than doubled the size of its transfer pricing resources.

The UK has been heavily involved with the OECD in transfer pricing by helping to draft both the guidelines and the approach to profit attribution for permanent establishments. The UK has gone so far as to enshrine the use of the OECD's Transfer Pricing Guidelines in its domestic legislation.

However, unlike many countries, there are currently no set requirements regarding record keeping. This is helpful for multinational groups as it allows them to tailor their record keeping in line with their own requirements. Although, it does mean that a group may not have certainty as to whether the records they are keeping will satisfy HMRC.

The UK Government is, though, consulting on whether to introduce record-keeping requirements. If introduced, these are expected to take effect from April 1, 2022.

Transfer pricing is also now being used across other areas of UK taxation. For example, both the Controlled Foreign Companies regime and the Foreign Branch Exemption use transfer pricing principles to quantify the UK tax due.

In 2015, the UK introduced the Diverted Profits Tax to tax companies that it viewed as avoiding UK taxation by structuring their operations, using transfer pricing principles, such that little or no UK tax was being paid. The Diverted Profits Tax rate is currently set at a punitive 25% (rising to 31% from April 1, 2023), but it can be removed if a group changes its transfer pricing policies such that relevant profits are brought into the UK.

The UK also has a well-established and funded Advanced Pricing Agreement/

Mutual Agreement Procedure team that can assist UK multinationals with cross-border disputes.

Although litigation is kept as an option by HMRC, there has only ever been one transfer pricing case that has reached the Courts. HMRC prefers to settle any disputes through negotiation.

2 Are there any key issues that local TP/Tax examiners are focused on in your jurisdiction?

The two major areas that HMRC is concentrating on with respect to transfer pricing are the Diverted Profits Tax and the accuracy of information used to prepare transfer prices.

For the Diverted Profits Tax, HMRC has opened a *disclosure facility* under which a group can make a report to HMRC declaring old Diverted Profits Tax liabilities and face lower or no penalties. Alongside this facility, HMRC has been issuing *nudge letters* to companies that they believe have a Diverted Profits Tax exposure. If, after receiving such a letter, no disclosure is made and HMRC finds a liability, penalties will almost certainly be charged.

With respect to the accuracy of information, HMRC has found that what is happening *on the ground* is different from what is stated in transfer pricing reports and/or contracts. When examining a transfer pricing issue, HMRC is looking to get behind the report and contracts to the real facts. To this end, HMRC is increasingly interviewing staff and making use of the exchange of information articles in the UK's wide tax treaty network.

Multinationals should note that HMRC has started criminal prosecutions against companies and individuals in cases of willful misrepresentation of facts on a transfer pricing issue. This is unprecedented in the UK for non-tax evasion matters.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

The principle act taxpayers can take is to ensure that their transfer pricing documentation accurately describes what is happening *on the ground*. Any old reports or contracts should be examined along with interviews of key management as a matter of urgency to ensure they correctly reflect what is happening and have not become outdated. As mentioned above, out of date contracts can lead to penalties or worse. If HMRC notices discrepancies that appear deliberate, it could potentially prosecute.

A review should also be undertaken to ensure that any UK Diverted Profit Tax exposure is considered and proactively dealt with. An increase in UK tax due to a change in transfer pricing may be relieved via double taxation relief, however, Diverted Profits Tax is often not relievable and may be an absolute cost to the business. ■

India

> India has been predominantly an inbound economy, where its growth story may be significantly linked to the era post-globalization initiated in the early 1990s.

Nitin Narang - Managing Director/Partner
Nangia Andersen India Pvt. Ltd.
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

India has been predominantly an inbound economy, where its growth story may be significantly linked to the era post-globalization initiated in the early 1990s. Since being promulgated Vide Finance Act, 2001, as a binding statutory framework, the TP legislature in India has constantly evolved over the years, keeping pace with the international best practices and global developments with regard to the OECD's Base Erosion and Profit Shifting (BEPS) report on Action Plan (AP) 4, 8, 9, 10, 13, 14 and 15.

Indian TP regulations are largely in line with the OECD's TP Guidelines for multinational enterprises (MNEs) and tax administrations. Some of these include range concept, use of multiple-year data, secondary adjustment provisions, Advance Pricing Agreement (APA) program, Mutual Agreement Procedure (MAP), and safe harbor rules.

However, there are some unique features also, which make it distinctive from the general transfer pricing guideline followed worldwide. These include Domestic TP regulations, the concept of deemed international transactions, use of the arithmetic mean (in case of fewer than six comparables), use of customized and narrow range (i.e., 35th to 65th percentile if more than six comparables), and prescribed sixth transfer pricing method (i.e., other method).

Over the past years, the Indian Tax Authorities (ITA) have introduced several reforms in the TP regulations to reduce TP litigation such as the introduction of alternate dispute resolution mechanisms such as APA, MAP with countries not having Article 9(2) in the treaty, safe harbor rules, forming Dispute Resolution Panel, and replacing the method of selection of cases by the tax officers based on threshold criteria to risk-based assessment. Further, the Income Tax Appellate Tribunals and Indian Courts have also provided important guidance over various TP issues.

Currently, the Indian TP regulations are wide enough to cover various aspects of complex transactions involving:

- Intangible assets including marketing, human assets, or technology-related intangibles
- Global business reorganizations or restructuring
- Financial transactions including corporate guarantee

Some of the significant litigated TP issues in India include the marketing intangibles issue, profit attribution to PE in India, location savings, remuneration and characterization of contract research and development (R&D) centers, and benchmarking of financial transactions.

In the backdrop of COVID-19 and the ever-changing global business landscape, TP is one of the most important areas of focus for the ITA.

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

Indian TP litigation landscape has matured over the course of years with TP adjustments peaking at INR 700 billion (approximately USD $12 billion) during FY 2012-13 (source: FY 2013-14 and FY 2014-15 Annual Reports published by India's Ministry of Finance covering TP developments).

Recently, the ITA has started to focus more on a comprehensive understanding and the taxpayer's contribution to the entire value chain. In case of TP audit, the tax officers request for meetings with operational or technical employee to delve deeper into the functionality of business activity (whether manufacturing, trading or services) and place heavy references on press releases or professional media platforms such as LinkedIn, as well as taxpayers' internal job description and performance appraisal documents.

During the initial nascent years of TP audit, the focus of the ITA was on regular filter or comparable analysis, which then shifted to intra-group services, royalty payments, financial transactions, receivables cycle, cost recharges, treatment of free of cost assets, and Employee Stock Option Plans or Restricted Stock Units.

In case of transactions involving intangibles, the ITA conducts Development, Enhancement, Maintenance, Protection and Exploitation (DEMPE) analysis to evaluate the creation, presence and ownership of intellectual property (IP) involved, which is also a key requirement in case of highly litigated TP issue pertaining to the creation of marketing intangibles by Indian taxpayer of the foreign parent.

Currently, the ITA is having a lot of experiential learning and internal knowledge sharing from officers handling APAs, MAPs with broader learning through other jurisdictions with access to detailed competitive data across a wide variety of industries. Additionally, with the implementation of BEPS AP 13 and shift to risk-based assessment, the focus has shifted from quantity to the *intensity* of audits with access to expansive data in three tier documentation to complement the TP audits.

Also, with India as a participant in the BEPS AP 14 and 15 initiatives and also a signatory to multilateral instruments (MLI), there has been significant training and skill development for the ITA officials to deal with newer realities of business model transformation.

Some of the significant litigated TP issues in India include:

- Marketing Intangibles: In a number of cases, the ITA has alleged that the advertising, marketing and promotion (AMP) related activities and expenses add value to the trademark or brand legally owned by the foreign related party by way of brand building. Thereby concluding that the local Indian subsidiary must be compensated by the legal overseas brand owner for the benefit bestowed on an *arm's length* basis.

- Profit Attribution to PE in India: The attribution of profits to a PE has always been contentious, and there is a lack of guidance in the regulations. In many cases, attribution has been done by either considering the profits as per the percentage of revenue accruing or arising considered reasonable by the ITA, or profits are derived as a proportion of the total business profits of the non-resident based on the ratio of revenue accruing or arising in India to total revenue.

- Location Savings: These are net savings in cost obtained by a MNE through relocating its core operations from a high-cost jurisdiction to a low-cost jurisdiction like India. The major dispute with regard to location savings is based on the premise that the price determined on the basis of local comparables does not adequately allocate location savings, which comes along with further challenges of quantification of such location savings or extra profits and attribution of the same amongst the Indian subsidiary and the related party.

- Contract R&D Centers: The ITA has objected that, notwithstanding the formal structures of contract R&D service provider model being put in place, high value-adding and sophisticated services are performed by the Indian contract R&D centers which in return leads to the generation of valuable and unique intellectual property from the work undertaken in India. Accordingly, the Revenue alleges that the Indian R&D center becomes the economic owner of intellectual property which is transferred without adequate compensation.

- Financial Transactions: Issue of guarantees, intra-group loans, newer hybrid instruments to raise funds, thin capitalization rules and others are under litigation due to lack of guidance, both in domestic regulation and international literature. Also, computation of *arm's length* price or range of financial transactions is a very niche area, requiring significant expertise in execution and the deployment of sophisticated databases.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Having discussed the key focus areas by the ITA, the taxpayers need to maintain comprehensive and robust documentation to survive TP audit in India. Taxpayers need to ensure TP outcomes are aligned with value creation. For example, contractual assumption of risk must coincide with the actual conduct of parties (i.e., ability to control risk through the decision making and financial capacity, identifying the economic owner of an intangible by undertaking DEMPE analysis, etc.).

Taxpayers need to ensure actual conduct is reflected in all documentation (i.e., TP such as intercompany agreement and TP report or non-TP such as business and commercial correspondences, press releases, social media platforms, all internal company documents including employee job description, appraisals, etc.) and alignment of TP report with the master file (i.e., taxpayer's functional profile in relation to supply chain resonates with group's macro level supply chain).

While formulating TP policy, the focus should be on *full value chain* review vis-à-vis earlier one-sided TP analysis, and taxpayers need to regularly monitor and regulate its transfer prices in order to adapt to the ever-changing/dynamic business and economic environment. In the Indian context, given the availability of a narrower *arm's length* range and expectation of higher market returns by the ITA, it is imperative for taxpayers to align well with the group's TP policies.

In terms of managing TP risks and especially with the impact of COVID-19, these can be summarized as follows:

- Revision of TP Policies: Taxpayers should review existing TP policies to align transfer prices to current economic realities and proper characterization of the entities in accordance with their FAR analysis. This would also require corresponding amendments in Global TP policies and master file (MF) filings.

- Revision of Intercompany Agreements: Intercompany agreements form the backbone of the transactions and acts as a window to how the MNEs operate. It is thus important to review and update the terms of intercompany agreements to align the economic substance of the transactions to their form as well as reflect the new TP policies.

- Business Restructurings: The pandemic has led to various disruptions to business operations. Businesses may therefore choose to adopt different structures to ensure operational efficiencies within the group. Considering the need of the hour and the ever-changing business environment, changes in supply chain and DEMPE related functions are inevitable.

- Preparation of robust TP Documentation: The importance of the TP documentation cannot be overemphasized or undermined in any situation. The go-in position of any taxpayer should be as robust, self-explanatory and detailed as possible to achieve the objective of sailing through any audit. This should also include the selection of appropriate *arm's length* profitability indicators and computation of economic adjustments to align with the economic conditions.

On an overall basis, while robust TP documentation remains an important document to start with, with the increased digitation drive by the ITA, interlinkage in multiple compliance reporting across various sections of the law, sharing of information between customs and direct tax wings of government and the recent introduction faceless assessment and appeal proceedings, utmost priority should be accorded by taxpayers to harmonize all aspects of reporting from a larger compliance and audit risk management standpoint. ■

Argentina

Argentina was one of the first Latin American countries to incorporate transfer pricing provisions aligned with the OECD Transfer Pricing Guidelines.

Cecilia Goldemberg - Managing Director/Partner
Andersen in Argentina
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Argentina was one of the first Latin American countries to incorporate transfer pricing provisions aligned with the OECD Transfer Pricing Guidelines. These regulations were introduced in 1999.

However, the adoption of the *arm's length* principle has existed for a long time. The provision keeps the same writing from its origin. The difference is that before 1999, comparable search methodologies considered the comparison of transaction prices linked to wholesale prices in the origin and destination market, for import and export operations, respectively, while financial transactions and the ones involved in the transfer of technology were governed by special regulatory controls.

The incorporation of the Transfer Pricing OECD Guidelines (selection of the most appropriate method, functional or FAR analysis, interquartile range, comparability adjustments, annual report, etc.) was focused on their functionality as anti-evasion measures (that is why implementation extends to operations with entities located in jurisdictions of low or no tax or non-cooperating jurisdictions) without considering, at the same time, relief measures for cases of double taxation. Such is the case that the APA regulation was just incorporated in the reform of 2018 (Law 27.430) as well as the MAP process. The experience of tax authorities in that field is very limited.

Argentina is not a country member of the OECD, however, since it is a part of the Group of Twenty (G20), it participates actively in Working Group No. 6 and is a part of the OECD/G20 Inclusive Framework. It is a signatory of the CbC Multilateral Competent Authority Agreement as well as the Multilateral Convention (BEPS action 15). It has 19 DTAs in force, 15 of which include the corresponding adjustment (Article 9 par. 2).

In the beginning, the tax auditing work focused on specific industries, such as

automobile and pharmaceutical industries, but mainly in the agricultural exporting model since Argentina is the third-largest exporter of flour and soybeans in the world (note that this industry is accordingly a major source of foreign exchange). Without a doubt, the TP rules forced examiners to gain deeper knowledge about the industry's operations, which generated some suspicions, because the operations with grains and oilseeds tend to be negotiated through forward contracts and with prices to be fixed in relation to a future price quoted in the Chicago Board of Trade and through prior agreements made with respect to premiums and discounts. Since the commodity business exports usually involve related international traders, tax authorities promoted an amendment to the Income Law that incorporated the *sixth method*, which required considering as minimum price the quoted one on the date of shipment, without considering the price agreed between the parties whenever a trader intervened. These criteria led to many jurisprudential cases.

Argentine professional and corporate institutions and boards issued strong arguments during the public consultation period, which finally allowed the OECD not to take the position of the Argentinian Treasury (see TP Guidelines, Chapter II). Rather, tax administrations should consider the pricing date as a reference date for determining the price of commodity transactions.

The reform in place since 2018 replaced the *sixth method* with a register of contracts of exports, incorporated specific controls on foreign triangular trades, established the benefits test for services, incorporated specifications about segmentation and precise regulations for financial operations and intangibles, among other issues. On the other hand, regulations set as mandatory to select the local company as a tested party, which in some cases conspires against the reliability of the analysis, safe harbor principles have not been adopted for lower-risk operations, so the burden of compliance for the taxpayer is a high one. Additionally, the high inflationary economic conditions in Argentina make it very complex to implement the comparability analysis, to which we should add the lack of public information of local comparable companies, a situation that, in general, applies to the whole region.

2 Are there any key issues that local TP/Tax examiners are focused on in your jurisdiction?

In general, the tax audits are very inquisitive about the activities and positions of local companies in a multinational value chain, with requests for evidence to confirm the FAR analysis, a detailed review on the economic analysis made by the taxpayer, the selection of comparable transactions, adjustments performed, etc. The degree of litigation is high. The most important points raised by examiners refer to the benchmarking analyses, PLI selections, rejection of the application of the CUP method, averaging operations, preference of internal comparables, recharacterization of financial transactions into capital contributions, and objections or adjustments to comparable ranges.

Also, the triangular exportation of goods is still a high-priority issue for the Federal Administration of Public Income (AFIP). Such is the case that it has placed the focus on the differences between the values of the exports of goods (not only commodities) registered in customs offices in the country of origin (Argentina) and destination (usually Brazil) in any operation where a related trader intervenes, requiring an allocation of the price difference on the taxpayer side. These *aggressive* assessments are currently being discussed before the Argentinian Tax Court.

Other essential points have been expressed in recent administrative regulations, emphasizing:

- Operations with related traders exceeding USD 350,000: provide evidence by means of an accounting certification that remuneration is aligned with functions, assets and risks (apart from looking for information about its financial states and other elements). This requirement represents a challenge since it is necessary to be transparent in connection with the possible existence of intangible assets or essential functions being conducted which may be the characteristic of an entrepreneurial role, besides the sole function as an intermediary in the purchase and sale of goods.
- Intangible assets: compensation for the development of functions, control or risk-taking on the part of the local subject that contributes to the value chain of an intangible asset, estimation of the market value of the contribution made in research and development activities, guidelines to apply the Profit Split Method in such cases.

- Financial operations, including the grant of guarantees: a bilateral analysis is required on the economic and financial capacity of the lender to grant the loan and bear the associated risks and the financial capacity of the borrower for the repayment of capital and interest, provided it is accepted to consider the implicit support of the multinational group, debt ratios (indebtedness and borrower) in case of cash pooling.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

The taxpayer has to be coherent in their position and must provide the tax administration with evidence, including pertinent documentation on the behavior assumed in relation to transactions consistent with the criteria established in the signed contracts, and at the same time, with the same objectives than an independent company may have adopted considering the available options.

This way, proper management of the local file, with the description of the functional analysis and particularly of the risks undertaken by the parties to a transaction, the description of the position of the contributor in the value chain, with the due characterization of its activity, the reliability of the economic analysis, of the selection of the most appropriate method and the selection of comparables and comparability adjustments performed, are all the steps that should be taken with documentary evidence.

The TP position will be examined by the AFIP because in Argentina the economic reality has clear pre-eminence. For example, it is very common that the case of manufacturers who at the same time supply both the external and the internal market, therefore undertaking full risks, and in such cases the control of the supporting documentation on low risks undertaken in the provision of goods manufactured for related companies will be essential to keep a benchmark aimed at low-risk manufacturing (principal planning of production, delivery organization methods, technical specifications, logistics, centralized purchases, etc.).

For some specific situations with respect to which new regulations impose the obligation of submitting evidence in the local file, for example, professional certifications on the *arm´s length* remuneration of international traders or certifications on the financial capacity of borrower or lender, as the case may be, the provision of these elements constitutes evidence. Consequently, submitting said documentation already offers protection to the taxpayer in connection with such issues.

The taxpayer should also gather evidence about the facts that justify possible changes in the contracts, for example, regarding the hard impact caused by the COVID-19 crisis, in case that the entity has been affected. Many entities have amended their service contracts, for example, considering not only the reduction of the mark up to be applied but also the currency, since in Argentina it may be unfeasible to bear the exchange rate risk, in certain cases. Computable costs could also be reformulated, if applicable.

It also should be pointed out that consistency with the master file and with the criteria undertaken by the counterparty in respect to the transaction under analysis is also important in order to avoid contradictions or inconsistencies. ■

Brazil

> The legislation and all the rules as well as the understanding of the major points are very mature (set forth in 1998) and the tax authorities' assessments are very constant in their approaches. "

Luiz Albieri - Managing Director/Partner
Albieri e Associados
Collaborating Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Brazil is not an OECD member and it directly affects the transfer pricing administration. Its rules are not in accordance with OECD guidelines, on the other hand, the method's principles are basically the same (cost plus, resale price, comparable uncontrolled, commodities list price).

The legislation and all the rules as well as the understanding of the major points are very mature (set forth in 1998) and the tax authorities' assessments are very constant in their approaches.

Brazil's transfer pricing rules state that the imports and exports of goods, services, rights and financial transactions established with related parties have to be analyzed by one of the possible methodologies. The methods to be applied are based on three principles, which are cost plus, comparable uncontrolled prices and the resale price.

Additionally, there is no *best method* rule; as such, the taxpayer has the ability to choose the method that provides the least taxable income.

Transfer pricing-specific returns

Brazilian taxpayers are required to document their international intercompany transactions on an annual basis. The Corporate Income Tax Return (ECF) contains specific forms that require taxpayers to disclose detailed information regarding their intercompany import and export transactions. As part of these contemporaneous documentation requirements, taxpayers need to disclose the total transaction values for the most traded products, services or rights, the names and locations of the related trading partners, the methodology used to test each transaction, the calculated benchmark price, the average annual transfer price and the amount of any resulting adjustment.

Definition on Related Entity

According to the Brazilian rules, the following entities or individuals may be treated as related or associated with a company domiciled in Brazil:

- Its parent company domiciled abroad
- Its affiliates or branches domiciled abroad
- Individuals or legal entities resident or domiciled abroad whose shareholdings in its capital make them its controlling shareholder or associate companies
- Its subsidiaries or associated companies domiciled abroad
- Legal entities domiciled abroad, when these and the company domiciled in Brazil are under the same corporate or administrative control or when at least 10% of the capital of each of them belongs to the same individual or entity
- Individuals or legal entities resident or domiciled abroad that together with the corporate entity domiciled in Brazil have total shareholdings in another corporate entity as its controlling or associated company
- Individuals or corporate entities resident or domiciled abroad that are associated to it, in the form of consortium or condominium, as defined in Brazilian legislation
- Individuals resident abroad who are relatives or kindred up to a third degree, spouse or cohabitant of any of its directors or of its direct or indirect controlling partner or shareholder
- Individuals or legal entities resident or domiciled abroad that are its exclusive agents, distributors, or concessionaires for purchase and sale of goods, services or rights
- Individuals or legal entities resident or domiciled abroad for which the Brazilian entity acts as the exclusive agent, distributor, or concessionaire for the purchase and sale of goods, services or rights
- Taxpayers are expected to have the calculations and documentation necessary to support the information filed as part of the annual tax declaration, ready for potential inspection by the tax authority as of the declaration's filing date (i.e., usually the end of June of the following calendar year)

Priorities/pricing methods

For import transactions, deduction of costs and expenses on import transactions will be limited to the greatest benchmark price calculated under one of the following statutory methods:

- Comparable Independent Price Method (PIC)
- Production Cost plus Profit Method (CPL)
- Resale Minus Profit Method (PRL)
- Quotation Price on Imports Method (PCI)

The minimum threshold for taxable revenues on intercompany export operations should be established under one of the following methods:

- Comparable Uncontrolled Price (PvEX)
- Wholesaler's Resale Price (PVA)
- Retailer's Resale Price (PVV)
- Cost Plus (CAP)

- Quotation Price on Exports Method (PECEX)

Note that, Brazilian TP legislation gives to taxpayers the option to choose the most favorable method to justify import transactions from the transfer pricing perspective (the most favorable method that would result in the most beneficial tax result for the taxpayer).

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

There are few specific points that every tax audit gives special attention to, disregarding the economic sector of the taxpayer and the kind of products, services or rights are under analysis. They are:

- Product, Service and Right grouping
  The local rules allow the taxpayer to group its imports and exports utilizing a similarity approach, according to Article 42 of the Normative Ruling 1.312/12. Notwithstanding, its applicability is very subjective and may be disregarded by the tax auditor if he/she does not feel very comfortable about the methodology utilized and the reasonability of the outcome. In this scenario, the best way to run the calculations and analysis is firstly trying to not group the products, services, or rights. After that, if tax adjustments may be minimized by grouping them, it is recommendable to be conservative in the approach.
- Cost breakdown information
  Both cost-plus and resale price methods use the production cost information. So, the cost controls are very sensitive to the tax audits.

  The issue here is that the production cost information brings with it much other information as inventory, bill of material, indirect costs considered in the final product cost, proration criteria utilized among many other sensitive data. Therefore, it is very easy to have this satellite information challenged by the auditors and even bringing to the attention other issues not related to the transfer pricing itself. It is not difficult to find audits that have started with transfer pricing and ended with a full income tax audit due to accounting criteria and costs allocation.

  Regarding the resale price of the final product sold in the Brazilian market that uses imported parts.
- Effective Price
  The way the taxpayer calculates the effective price of the imports and exports held with its related parts are very important and 100% of the time they are a focus of the tax audit. In the Brazilian transfer pricing scenario, there are discussions regarding the utilization of the FOB, CIF, DDP, and other incoterm clauses to calculate the effective price of a given importation or exportation depending on the method the taxpayer will use to do the analysis. Therefore, it is also recommendable to be updated in the most recent interpretations and litigations attached to this theme.
- Safe Harbor
  Exclusively to the export transactions, the taxpayer has two possible ways to make a global analysis that, depending on the outcome, be released of doing the product by product calculation. They are the profitability and the representativeness of global computations. If the company is utilizing one of these safe harbor approaches it certainly will be a focus of any tax audit. In this case, it is strongly recommended to stress and challenge the numbers utilized, prorations criteria,

and other possibly sensitive information to guarantee the safe harbor will be accepted by the tax authority.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Given the detailed transactional focus of the Brazilian regulations and the absence of any basket approach, taxpayers are required to document their transfer prices on a product by-product, service type by service type, and right by right basis.

In this context, product refers to a company's internal product used for inventory management purposes, and not to the much broader fiscal nomenclature used for customs and indirect tax purposes.

The following points are considered key to successfully attend the tax audits in Brazil:

- Do all the calculations every year
  Once the taxpayer is not obliged to fill the transfer pricing sections at the income tax return (it is a flag that the taxpayer can check or not), it is common to find companies that chose to postpone the transfer pricing analysis for many reasons, like short budgets to run the calculations, difficulties to gather all the information needed to comply with the methods and so on. This procedure is not recommended once more and more the tax audits made by the government are becoming automatized and faster.
- Keep the documents updated mainly the foreign ones
  The tax audits are very document driven. In this scenario, it is very important to have a track of every single number and information used in the calculations. Methods like cost-plus on the imports, for example, need the production cost information from the foreign-related part. This kind of information needs to be very well supported by proper documents as the inventory control, bill of material, official reports from the ERP, and so on to be easily accepted by the tax authorities.
- Fulfill the tax return in the specific requirements to transfer pricing
  The transfer pricing section at the income tax return has many cross-references to check if the information filled by the taxpayer is consistent among them and the other sections of the return. An inconsistency or a tie-in fail in this filling may bring attention to the automatic checks made by the government's internal systems. So, it is strongly recommended to have an expert verification of these matters before file the income tax return. ■

Colombia

> In Colombia, transfer pricing rules were incorporated in our tax code in 2002, but since 2006, the tax administration has required transfer pricing reports for some taxpayers based on the number of transactions with related parties abroad.

Leidy Natalia Rojas Garcia - Manager
JHR & Asociados
Collaborating Firm of Andersen Global

1 What is the current state of TP administration in your local country?

In Colombia, transfer pricing rules were incorporated in our tax code in 2002, but since 2006, the tax administration has required transfer pricing reports for some taxpayers based on the number of transactions with related parties abroad. In the reform of 2016 (Law 1819), some transfer pricing rules were introduced related to BEPS, including the master file, local file and country-by-country report.

In reference to the OECD Transfer Pricing Guidelines, these guidelines are not included in our law, however, Colombia's Constitutional Court decided that these guidelines are valid for interpreting legislation. Currently, transfer pricing jurisprudence has included positions from the OECD Guidelines. Since April of 2020, Colombia officially is an OECD member, but there have not been changes in fiscal regulations from that status.

The tax administration has a special department focused on international control with professionals with work experience in tax firms. However, currently, there is a public process to hire more people in order to improve the inspection and fiscal collection. Also, there is the promotion of advance pricing agreements (APAs), but there is only one agreement of this type in Colombia because of the difficult and long process of negotiation.

Annually, the tax authority issues all of the technical rules for compliance, the formal duties of the regime, and publishes different concepts about topics including:

- Penalties
- Deadlines
- Implications on income tax return
- Tax havens
- Among others

Also, taxpayers submit reports, invoices, returns to the system MUISCA (an electronic data interchange system), which has all kinds of custom and fiscal information and is an important source of information to design control programs.

Currently, the TP administration is working on different audit programs, created from income tax returns of past years, annexes, profit margin of key economic activities, among others. It is important to point out that the tax administration has six years from the deadline of an income tax return to audit transfer pricing matters.

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

The transfer pricing regime has formal and substantial focuses.

Firstly, our TP examiners are focused on mainly formal aspects such as missing a deadline, inconsistencies with accounting and fiscal information, typing bugs, sending incomplete information, and mistakes in master file information. Unfortunately, these aspects are very onerous and could result in significant amounts of penalties. As a result, taxpayers undergo the litigation process, which could last up to eight years, until they get a final decision from a higher authority. Fortunately, most of the final decisions have been favorable for taxpayers, thereby reducing penalties and clarifying the main point of transfer pricing rules.

Nevertheless, many companies prefer to simply pay the penalties or apply for some

prompt payment benefits when available based on local rules.

In reference to substantial aspects, tax authorities have identified some red flags:

- Companies with concurrent fiscal and financial losses
- Transactions with tax havens
- Analyses based on gross margin
- Expenses in technical assistance services
- Use of budgets or forecast
- Level of segmentation of the taxpayer's financial data

- Comparability adjustments
- Incomplete functional analysis
- Withholding rate applied in transactions services
- Benefit test in services
- Transactions with related parts in free trade zones

Unfortunately, jurisprudence in substantial aspects is limited. The most important decision is in regard to comparability adjustments used by a taxpayer in a year with an out-of-range result caused by cost overruns for investments in plant production. Initially, these adjustments were rejected by the tax authority who claimed a larger income tax, however, after nine years, the high court ruled in favor of the taxpayer.

Recently, the tax administration is focused on verifying consistency between income tax returns and transfer pricing returns, through the review of annexes and information from other authorities.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Given the situation due to COVID-19, the tax administration has increased its transfer pricing audits. Thus, it is possible to have discussions not only for the Fiscal Year 2020 but also for previous years.

For these reasons, it is necessary that taxpayers evaluate how they have done transfer pricing reports in Fiscal Years 2018 and 2019 and if they are consistent with

income tax returns and other fiscal duties. If there are discrepancies, it is possible to adjust information and avoid arguments with the tax authority.

To safeguard their TP positions, taxpayers must:

- Identify in advance the formal and substantial duties for the Fiscal Year 2020.
- Before submitting an income tax return, verify if transactions with related parties comply with the *arm's length* principle. If not, check if it is possible to adjust or explain an out-of-range result. It is necessary to explain reasons with reports, bills, agreements, local rules among others, to defend a financial loss or another result out of the *arm's length* range. If there is no defense or explanation, it is necessary to make an adjustment in the income tax return.
- Check financial transactions, thin capitalization rules, and requirements for comparability analysis (risk, interest rate, guarantees among others).
- Compile relevant information/data about the COVID-19 situation that could influence a company's transfer pricing results. Also, it is important to verify if there were changes in any transfer pricing policies.
- Review intercompany agreements including terms, supporting documents, etc.
- Prepare a defense file, to support services, financial transactions, and intangible assets with related parties. ■

Ecuador

> In 2005, Ecuador entered the transfer pricing regime in accordance with Article 91 of the Tax Code.

Mauricio Durango Pérez - Managing Director/Partner
Andersen in Ecuador
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

In 2005, Ecuador entered the transfer pricing regime in accordance with Article 91 of the Tax Code. This included reforms in the Ecuadorian tax regime and its regulations (Ley de Régimen Tributario Interno y Reglamento) and the resolution issued by the tax authority (Resolution No. NAC-DGER2005-0640). These rules are primarily intended to reinforce the prices at which a company transfers physical goods and intangible property, provides services, or performs any type of operation with related companies.

Under this regime, taxpayers who perform operations with related, national or foreign parties are required to determine the prices and profit margins for these transactions. These prices must be comparable to or between transactions with/between independent parties.

Since the first year it was implemented, it has involved exhaustive administrative efforts for both taxpayers and the tax administration. Transfer pricing is multidisciplinary, involving much more than tax issues. It connects legal, economic and accounting notions as well. The degree of complexity that conducting these studies entail, partnered with highly confidential information and the need for international databases present the need to hire experienced, reliable and competent advisors.

The tax authority has the technical capacity to evaluate and determine the authenticity of the information provided by the taxpayers, as maintained by the economic reality. This means that the process, consistency, methodology and reality with which the transfer pricing documentation was developed will be assessed. It should be noted that for this purpose, the tax authority has three years to assess, after which its determining power will expire unless it proves that the income registration has

been omitted or excluded in the income tax return of the taxpayer, in which case the assessment competence expires in six years.

Thus, the tax authority seeks that the taxpayer understands the importance of transfer pricing and to emphasize that there is no point in denying or hiding this information can be easily cross-referenced with all the sources of information and with the data analytics the tax authority manages. It also aims to raise awareness of the responsibility of taxation, which means paying the right amount.

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

Given the global pandemic we are experiencing, countries have taken several steps to counteract the repercussions, which has had implications for all trade and productive sectors.

The challenges that companies will face presently and moving forward are substantial since the economic stability of businesses must be sought out. This is without forgetting the obligations they maintain with the tax authorities of each country, the same ones that will guarantee compliance with all of them, among which are transfer pricing.

The tax administration will carefully examine related transactions from a very deep perspective to understand the degree of the economic impact the pandemic has had on the business and probably will try to take advantage of these changes in further years.

During the COVID-19 crisis, sectors that have potentially lost have been identified, but sectors that have won in the market have emerged as well. All of them must have robust functional studies covering assets, functions, and risks of the company, which must be duly and technically concatenated/connected with the current circumstance and clearly describe how COVID-19 has affected the business and operations between related parties. This must aim to resolve the economic analysis of these transactions against the revisions that the tax authority will carry out. It will even be helpful to face possible tax audits.

In this sense, although the Ecuadorian Tax Administration has not accepted the use of comparable companies with losses, under the *Ficha Técnica para la Estandarización del Análisis de Precios de Transferencia* (Ecuadorian guidelines to elaborate transfer pricing documentation), it has stipulated that they would accept the use of comparable companies with losses, provided that they demonstrate that such losses (both of the tested party and comparable parties) are due to the same sector and similar circumstances. This is in accordance with verbal conversations maintained with officials of the International Taxation of Ecuadorian Tax Authority.

In reference to *Consulta Sobre Valoración Previa*, equivalent to the Advance Pricing Agreement (APA), we must be aware of the pronouncement that the tax administration has had in this regard. Consultations

approved before the pandemic and that have been in force during 2020, as well as those consultations that have been approved during 2020, will surely have to present adjustments or renegotiations. This is because the conditions under which the information for the negotiation was presented and evaluated had to change in many of them. We expect the tax authority to conduct the assessment where it will certainly find companies with severe operating losses.

Finally, our tax authority is expecting OECD guidance on the transfer pricing implications of the COVID-19 pandemic which will allow a more effective enhance tax certainty for both, the tax authority and businesses.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Tax authorities around the world are adapting processes and methodologies for a full review of the functional and economic effects of COVID-19 on companies. Therefore, companies should have the relevant documentation of their transactions with related parties to be examined in the report, and ensure sufficient economic support in terms of any impact the COVID-19 pandemic during 2020 may have had on business results, and at the same time, examine how these changes can be adapted to the new reality without implying risks when they return to normality.

Taxpayers should carefully analyze functional effects or changes and assess the impact on functions, assets, assumed risks, and any resulting impact on the income statement as well as balance sheets. Additionally, the best transfer pricing methodology must be established, as well as the most appropriate comparable ones for contrast. As a firm, our recommendation is to initiate the analyses and prepare the documentation before the fiscal year ends, to better support a robust functional analysis that translates into reliable and real economic results, establishing with or without the need for extraordinary adjustments.

As noted above, in compliance with transfer pricing obligations and given the revisions and audits presented in Ecuador, all taxpayers should be concerned not only with the formality of the submission of the transfer pricing documentation, but of the veracity, sustenance and quality thereof from a comprehensive perspective (legal, contractual, accounting, financial and tax).

The purpose of transfer pricing reports is to provide transparent and easily understandable analysis, with reliable results and with the corresponding annexes and supports (contracts, calculations, financial statements, analyses, among others). Therefore, it is important that taxpayers follow the best practices to ensure high-quality transfer pricing documentation. Since transfer pricing should not only be viewed just as a formal legal obligation to the tax authority, but also as an internal control and financial decision-making tool. It can also be used to effectively address any determinations or questions by the tax authority. ■

Mexico

> It is important to note that during 2019 and 2020, the SAT triggered an important protocol to follow up on audit processes within the Maquila industry and automotive sector.

Miguel Trejo - Managing Director/Partner
Gildardo Olivos - Managing Director/Partner
Andersen in Mexico
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

Mexico introduced transfer pricing rules in 1997 by including the *arm's length* principle in the Mexican Income Tax Law (MITL). Since then, the Tributary Administration System (know as *SAT* due to the initials in Spanish) has been modifying the TP rules for the Maquila sector (contract manufacturers in Mexico) and non-Maquila industries based on changes to government administrations. Currently, under the new presidential period of 2018 to 2024 called *4T*, the administration overseeing compliance regarding intercompany transactions (both domestic and international) has become increasingly difficult in terms of applying TP rules and tax compliance results.

TP Rules

Since 2014, transfer pricing rules for Mexican purposes are included in Articles 76-IX, 76-X, 76-XII, 179, 180, 181 and 182 which align with the Transfer Pricing Guidelines for Multinational Companies and Tax Administrations approved by the OECD.

It is important to note that during 2019 and 2020, the SAT triggered an important protocol to follow up on audit processes within the Maquila industry and automotive sector. This protocol establishes that taxpayers should provide SAT the minimal detail for TP purposes and follow appropriate tax compliance.

Obligation to Document (Transfer Pricing Study)

Article 76, Sec. IX (related parties abroad)

and XII (domestic related parties) of the MITL establishes the obligation on the taxpayer to produce and retain documentation proving that its transactions involving revenues or deductions carried out with related parties follow the *arm's length* principle.

Taxpayers Subject to These Obligations

Article 76 Sec. IX par. II lists the taxpayers exempted from this obligation:

- Taxpayers with business activities whose revenues in the prior fiscal year did not exceed MX 13'000,000 pesos are exempt.
- Taxpayers whose revenues derived from the provision of professional services in the prior fiscal year did not exceed MX 3'000,000 pesos are exempt.
- Taxpayers that, despite not exceeding the aforementioned revenue thresholds, are presumed to carry out transactions with companies or entities subject to preferential fiscal regimes are not exempt (Article 179, the penultimate paragraph of the Mexican Income Tax Law or the LISR).

Although Article 76 Sec. IX par. II of the LISR establishes which taxpayers are exempt from the obligation to produce and retain a transfer pricing study, it does not completely excuse them from all obligations with respect to transfer pricing matters. In the event of an audit by the tax authority (TA), it will be necessary to prove that transactions carried out with related parties were in compliance with the *arm's length* principle.

SAT Review Powers for TP Compliance

The powers of review with respect to transfer pricing matters are established in Article 46 Sec. IV (transfer pricing review) of the Federal Tax Code (CFF for its initials in

Spanish). If the taxpayer does not possess the transfer pricing study, it may be liable for infractions and fines for failure to meet this obligation.

Additional Compliance Obligations

Multiple Informative Returns (DIM for its initials in Spanish), Appendix 9 requires disclosure of all intercompany transactions where the related party is located abroad. Domestic transactions are not included in this disclosure.

BEPS Informative Declarations

Article 76-A of the MITL stipulates that the taxpayers indicated in Article 32-H Sec. I, II, III and IV of the CFF, must submit the

following informative declarations regarding related parties no later than December 31 of the year immediately following the fiscal year in question:

- Article 76-A Sec. I: master file on related parties in the multinational enterprise group (master file) (this requirement does not apply to domestic enterprise groups that do not have related parties residing abroad)
- Article 76-A Sec. II: informative declaration on local related parties (local file) (this requirement applies to all taxpayers indicated in Article 32-H Sec. I, II, III and IV of the CFF that have related parties in Mexico and/or abroad)
- Article 76-A Sec. III: country-by-country informative declaration (CbC or country-by-country)

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

Due to the COVID-19 pandemic, it is important for taxpayers to prepare a specific analysis of the impact of this crisis on the supply chain of products and services, as well as the possible existence of extraordinary expenses carried out during this period time and the effects on the operating profit of many multinational groups.

With this in mind, special negotiations between third parties and between related parties may be carried out to face adverse effects including the following:

- Renegotiation of contracts
- Modifications to the terms of payment
- Adjustments to sales prices
- Credit extension requests, among others

From a transfer pricing perspective, the circumstances and resulting impacts during this pandemic must be clearly documented by the taxpayer.

Therefore, a detailed analysis is necessary to consider when a taxpayer is preparing the appropriate transfer pricing that complies with the obligations established within the MITL regulation for the current period.

For maquiladoras on transfer pricing for transactions due to COVID-19

A maquiladora could apply for any of the following options:

- **Safe Harbor:** which determines the minimal tax profit result
- **Advance Pricing Agreement:** applies a specific methodology agreed upon between the Mexican Tax Authorities and the IRS called *Fast Track*

Safe Harbor

Companies opting for this alternative should consider that the cost base for the purpose of determining a 6.50% return could be increased by the factors mentioned above.

Also, when determining 6.90% on assets and inventories owned by a foreign resident in the maquila operation, foreign exchange rates should be considered.

APA option

Maquiladoras under an APA scheme covering the Fiscal Year 2020, will be directly affected by:

- The increase in the cost base on which a margin (fixed or variable, depending on the ratio intensity of the company) is applied resulting from the inclusion of COVID-19 expenses

- The increase in the asset base by converting to Mexican pesos the fixed assets and inventories owned by a foreign resident used in the maquila operation
- The outcome of the exchange rate fluctuation on the neutralization of the deductible/accumulative effect of financial items

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

The law requires all taxpayers to prepare and keep documentation that proves that all the transactions carried out with related parties are conducted pursuant to the *arm's length* principle.

The transfer pricing documentation must be prepared for each tax year and should have an evaluation *per type of transaction* and *per related party*. Mexican related parties are required to provide specific information in the transfer pricing documentation that includes the *arm's length* intra-group transactions.

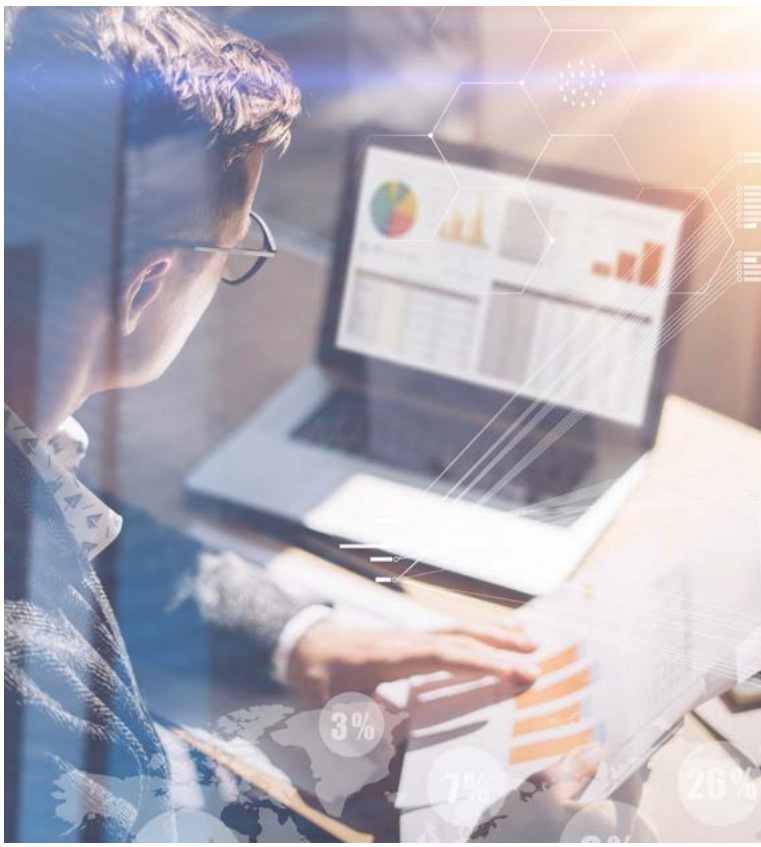
Hence the documentation should be considered as a defense file that will try to cover any additional aspect for tax purposes that a Mexican taxpayer should face from a TP perspective in connection with the tax position.

A Mexican taxpayer must disclose information regarding the conclusions of the transfer pricing documentation studies including:

- Name or firm name of the related company residing abroad
- Information relating to assets, functions, and risks per type of transaction
- Information and documentation with the detail of each transaction with related parties and their amounts per type of transaction
- Transfer pricing method applied, as well as documentation of comparable companies or transactions per type of transaction (it is worth mentioning that the range of results obtained from comparable transactions/companies must be the interquartile range)

The documentation substantiating transfer pricing matters must be prepared every year no later than the date when the annual tax return is filed. In the case of an informative tax return, it has to be filed no later than the date when the statutory tax report is filed.

The Mexican Tax Authorities conduct audits based on information provided by the taxpayer and other data, including information from international databases. ■



Uruguay

The Tax Reform Law 18,083 (July 2007) incorporated for the first time the transfer pricing (TP) regime under the rules of the corporate income tax.

Juan Ignacio Troccoli - Managing Director/Partner
Andersen in Uruguay
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

The Tax Reform Law 18,083 (July 2007) incorporated for the first time the transfer pricing (TP) regime under the rules of the corporate income tax. TP documentation requirements have been in effect since July 1, 2007, but they were not regulated until January 2009, with the publication of Decree No. 56/009.

The scope of the transfer pricing regulations includes transactions with non-resident related parties, low tax jurisdictions, as well as with free trade zones. Additionally, the regulations include a specific methodology to measure the taxable income derived from import or export transactions involving commodities.

Uruguay is not an OECD member, however, the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations are a key reference point in the application of the *arm's length* principle.

Resolution No. 2084/009

In December 2009, the tax authority, known as Direccion General Impositiva (DGI), issued Resolution No. 2084/009, which established requirements for a transfer pricing report.

In accordance with this Resolution, taxpayers are required to submit information on a yearly basis when meeting any of the following conditions:

- Taxpayers are engaged in transactions with related parties for an amount exceeding UYU 50 million (approx. USD $5.7 million) in the related tax period.
- The taxpayer is notified by the DGI.

The required information must contain:

- Transfer pricing report (local file)

- Tax return stating the details and amounts of the transactions of the period
- Copy of the financial statements for the fiscal period, if not submitted previously in compliance with other regulations

Resolution 2084/009 also states that taxpayers who are not required to file the annual information referred above must still keep the supporting evidence that justifies the transfer prices agreed upon with related parties and the comparison criteria applied, in order to duly demonstrate the correct determination of those prices and the profit margins declared.

The penalty for non-compliance with formal obligations (such as failure to file the tax return or the TP report) will be applied on a graduated scale, in accordance with the seriousness of the infringement. The maximum fine is approximately USD $250,000.

Advance Pricing Agreements (APAs)

Decree 392/009 introduced the APA instrument and states that the DGI may execute APAs with taxpayers, which must be signed before performing the transactions under analysis and that may not exceed the term of the three fiscal years.

BEPS information requirements

Law 19.484, published on January 5, 2017, introduced the country-by-country report (CbCR) and master file requirements. The CbCR was regulated by Decree 353/018 and Resolution No. 094/2019, and it applies to fiscal years beginning on or after January 1, 2017. Master file requirements are still yet to be fully implemented since further guidance must be published.

The CbCR filing requirement applies to Uruguayan taxpayers that are either the ultimate parent entity of a large multinational enterprise (MNE) group or a subsidiary of a foreign-parented group. The relevant regulations on this matter (Decree 353/018 and Resolution No. 94/2019) state that:

- Large MNE groups (with previous years' annual consolidated group revenue of EUR 750 million or more) must submit the CbCR in Uruguay unless a group member has submitted a CbCR in a jurisdiction with which Uruguay has an information exchange agreement and the report can be effectively exchanged with Uruguay.

The decree specifies the required content of the CbCR, which is aligned with the OECD Action 13 recommendations, and the filing deadline for the submission is 12 months after the closing date of the group's fiscal year.

- The decree also sets out the notification requirements for a local subsidiary of a large MNE group that must provide the tax authorities with the following information annually:
  - Name and tax residence of the entity that will file the CbCR for the group
  - Name and tax residence of the ultimate parent entity of the group
  - Names of other group members resident in Uruguay

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

In 2010, the DGI formed a specialist TP team, which has been actively performing TP audits. The issues the tax authority have mainly focused on are:

- Functional analysis and the position of the local company in the value chain
- The economic substance of foreign-related parties
- Revision of intercompany management fees on the basis that some taxpayers have not demonstrated the supporting documentation that such services have been effectively rendered (contracts, deliverables), the appropriate allocation of expenses and the benefit obtained by the counterparty
- Revision of the segmentation criteria applied
- Comparison between the financial information of the tested party and its financial statements
- Identification of potential internal comparables

- Benchmark analysis (revision of the search criteria applied and rejection of the selected comparable companies)
- Preference for local comparable companies for the benchmark analysis
- Comparability adjustments made to the financial information of the tested party
- Observations of local taxpayers that have continuous losses for many years

The DGI may use secret comparables as a means of proof for justifying the prices it has determined. However, there are no practical cases in which the DGI has done this.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Local rules require taxpayers to prepare and keep the supporting evidence of prices and conditions agreed upon with related parties and the comparison criteria applied, in order to duly demonstrate that intercompany transactions were conducted in accordance with the *arm's length* principle.

The outcome of the TP audits may depend on the strength of the documentation provided by the taxpayer. Therefore, in order to support the taxpayer's position, preparation of contemporaneous documentation is fundamental. Also, a solid functional analysis is crucial because it provides the basis for performing TP analyses of comparability with transactions between independent parties. In that regard, it is also important to provide an accurate and complete description of the products and services supply chain.

It should be noted that transactions between related parties cannot be supported solely by contractual terms, but must also be consistent with the allocations of assets, risks, and functions performed which must comply with the *arm's length* principle. It is of critical importance the preparation of detailed documentation to support the arrangements with controlled parties.

Further, consistency of the group's TP policy with the methods and profit margins applied with respect to the transactions under analysis is important in order to avoid contradictions.

In relation to the benchmark analysis, it is important to clearly document the process applied for the searches of comparable companies, as well as keeping the documentation related to the selection of comparable companies (financial information, business description, annual reports).

Regarding the COVID-19 pandemic, companies with impacted operations should evaluate the disruption on business models, re-examine their financing structure, and document the impact on transfer prices due to adjustments made to supply chains during the crisis. ■

Canada

> In 1998, Canada introduced Part XVI.1 of the Income Tax Act, Sec. 247 which includes the transfer pricing adjustment and re-characterization provisions.

Divya Katyal - Manager
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1 What is the current state of TP administration in your local country?

In 1998, Canada introduced Part XVI.1 of the Income Tax Act, Sec. 247 which includes the transfer pricing adjustment and re-characterization provisions. Before this, transfer pricing in Canada was governed by the avoidance rules concerning non-arm's-length pricing (Sec. 69).

Sec. 247 is divided into two parts, general transfer pricing rules and recharacterization rules. The general transfer pricing rules state that the terms and conditions of the transaction should be aligned with what would have been made between persons dealing at *arm's length*. The recharacterization rules state that the transactions or series should be aligned with what would have been entered into between persons dealing at *arm's length*, under terms and conditions that would have been made for bona fide purposes.

A secondary adjustment of a deemed dividend will be imposed if the repatriation of a primary transfer pricing adjustment to the taxpayer is not completed.

There are various other provisions in relation to non-resident related party transactions, such as below:

- Subsec. 15(1): Benefit conferred on a shareholder included in shareholder's income
- Subsec. 15(2): Amounts received from a Canadian corporation by a non-resident shareholder in the guise of loans or other indebtedness
- Sec. 17: Deemed interest income on loans to non-residents
- Subsec. 80.4(2): Deemed benefits on low interest or interest-free loans
- Subsec. 18(4): Thin capitalization rules

- Subsec. 18(6), 18(6.1) and 212(3.1) to (3.3): Back-to-back loan rules
- Subsec. 231.6 (1): Foreign-based information or document
- Subsec. 233.4(4): Returns respecting foreign affiliates

If the benefits are included in the income of non-resident shareholders, it is considered a deemed dividend. On such income, withholding obligations of 25% are applicable as per Part XIII of the Act. Treaty benefits can be claimed for lower rates.

The OECD Guidelines are not part of legislation in Canada. However, the Canadian regulations are broadly in line with these guidelines. There are several Transfer Pricing Memorandums (TPMs) issued to provide guidelines to taxpayers in relation to specific transactions and issues.

Form T106 is mandatory to file for reporting all of the international transactions with non-resident related parties if the aggregate of such transactions exceeds CAD 1 million and the transactions with one party exceeds CAD 25,000. It is required to be filed within six months from the end of the tax year in Canada and is enclosed with the tax return. If T106 is filed after the due date or not filed at all, penalties may be imposed.

The CbCR, master file and local file documentation requirements are in line with the OECD Guidelines.

The documentation should essentially be contemporaneous. It is not mandatory to file the documentation along with the annual tax filings, however, it is required to disclose in Form T106 whether such documentation is in existence or not. The documentation can be requested by the tax officer during an audit, and the taxpayer is generally obligated to submit the same within three months of such request.

The taxpayer is expected to make *reasonable efforts* to determine and use *arm's length* prices. If not, a penalty of 10% may be imposed on transfer pricing adjustments, if the net adjustment exceeds specified thresholds. This penalty is intended to be a compliance penalty focusing on the efforts that a taxpayer makes to determine an *arm's length* price and not solely on the ultimate accuracy of the transfer prices. Canada Revenue Agency (CRA) has issued

guidelines as to what constitutes *reasonable efforts* in TPM-09.

The documentation plays a very important role during an audit and therefore it is imperative to prepare it in due course and comprehensively. There is no hierarchy of preferred transfer pricing methods to be applied for analyzing the transactions.

There are no safe harbor rules prescribed in Canada. MAP and APA options are available.

For any government grants and subsidies received by the taxpayer, TPM-17 provides guidance on the treatment of these for transfer pricing purposes. This can be referred to for any subsidies received as a response to COVID-19 implications or for any R&D credits claimed by the taxpayer.

2 Are there any key issues that local TP/ Tax examiners are focused on in your jurisdiction?

In general, the CRA can reassess tax returns for corporations in four years from the original notice of assessment. The reassessment period can be extended further three years in certain situations, including where transactions involve a *non-arm's length* non-resident person. The reassessment can be made at any time if the taxpayer made any misrepresentations or committed any fraud in filing the return or in supplying any information to the tax authorities. The notice of assessment is usually issued within six months from the filing of the tax return.

CRA follows a risk-based approach in selecting cases for audit, and transfer pricing audits are a high priority. Recently, a substantial fiscal budget has been allocated for international tax disputes and audits. Special attention is given to transactions designed for profit shifting and tax avoidance in Canada.

CRA typically focuses on the characterization of the transaction and whether it was entered into for bonafide purposes. A broad analysis of the transaction as a whole is examined rather than piecemeal to ensure that the Canadian entity is remunerated at *arm's length* and gets its fair share of profit in the MNE.

The legal relationship of the entities is respected during an audit. Therefore, as mentioned above, it is very important to have robust documentation in place. However, if during an audit it is ascertained by the CRA that the transaction in substance deviates from its form (legal documents), it can be considered as *sham* and several GAAR provisions can apply along with re-characterization of the transaction as per the transfer pricing regulations. Several penalties can also be levied.

It has been upheld in several court decisions that taxpayers have the right to order their transactions to minimize tax.

CRA does not focus much on benchmarking because it does want to divert its resources on areas it views the taxpayer as having already made an effort. However, as mentioned above, there can be penalties imposed if the taxpayer did not make *reasonable efforts* to maintain documentation or to determine the *arm's length* price.

There have been certain instances wherein CRA has used comparable companies of other entities in the same industry and applied the computed *arm's length* prices on the transaction of the taxpayer under audit. These are not disclosed by the CRA due to the confidentiality of the other entities. The taxpayer has the right to litigate in such a scenario.

Canada plans to impose a tax on corporations providing digital services from 2022 and such tax is intended to remain until a common approach is agreed upon by the OECD countries.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

Canadian taxpayers can depend on legal documentation and paperwork to support their positions in disputes with CRA's auditors. Transfer pricing documentation shifts the burden of proof to the CRA to prove otherwise. This is slightly inconsistent with the U.S., where substance prevails over form in tax disputes. Therefore, it is very important to document the transactions, the risk profile and the economic analysis timely and comprehensively.

Also, a holistic overview of the transaction at a world-wide level can add substantial value to the documentation. In particular, due to the impact of COVID-19 on the profitability of the entity, it is very important to document the change to functional characterizations and justifications for any losses.

Taxpayers can apply for a ruling to obtain the opinion of CRA before the transaction is undertaken to obtain certainty. Taxpayers can also apply for an APA for eligible transactions.

There are also options of voluntary disclosures to disclose an earlier year's tax discrepancies to minimize the penalty and interest implications.

Parent companies based out in the U.S. commonly establish subsidiaries in Canada as an Unlimited Liability Corporation (ULC). These are disregarded as separate entities for tax purposes in the U.S. Due to this, often the U.S. parent neglects to maintain separate accounts for such entities. However, they are treated as a separate taxpayer in Canada and are not disregarded for tax purposes. Therefore, it is very important to maintain separate accounts on an ongoing basis to ensure correct recognition of the transactions and periodic TP adjustments. As mentioned above, documentation is of primal importance in Canada, and such recording of transactions in a timely manner can add significant value to the documentation. ■

United States

> Over time, administrators and examiners at the Internal Revenue Service (IRS) have become increasingly aware of the TP positions taxpayers have taken to lower their U.S. tax liability. ”

Kevin Kiyan - Managing Director/Partner
Andersen in the United States
Member Firm of Andersen Global

1 What is the current state of TP administration in your local country?

The U.S. is perhaps the jurisdiction with the longest history of administering TP regulations. In fact, current regulations reflect concerns written into U.S. tax law long ago about the potential for arbitrary income shifting by taxpayers to foreign-based related parties (War Revenue Act of 1917). The *arm's length standard* (ALS) was enshrined in tax regulations issued in 1935. Later, in 1968, detailed regulations providing procedural guidance regarding the application of the ALS were released. In 1994, formal regulations specifying contemporaneous TP documentation requirements were finalized and since then, the regulations have been continuously, frequently updated. Most significantly, detailed regulations regarding cost sharing arrangements (CSAs) were finalized in 2011.

Over time, administrators and examiners at the Internal Revenue Service (IRS) have become increasingly aware of the TP positions taxpayers have taken to lower their U.S. tax liability. This experience includes years of high-profile TP disputes litigated in U.S. courts. As a result, certain types of transactions automatically draw close scrutiny. For example, examiners pay close attention to outbound transfers of intangibles and the methods used to quantify the compensation paid. In other cases however, lengthy experience with TP-related examinations and disputes has led to more taxpayer-friendly provisions. For example, final services regulations released in 2009 allow taxpayers to charge intercompany service fees at cost without an additional markup for certain types of services.

Today, TP examinations are widespread and routine. Lately, the agency has successfully recruited a number of experienced technical professionals formerly employed as TP practitioners from both professional service firms and in-house tax departments. This adds to their already deep pool of talented

TP resources. Moreover, IRS examiners no longer grant automatic penalty protection to taxpayers with formal TP documentation. Pursuant to statements and formal guidance released earlier this year, TP reports must provide a clear, persuasive fact-based narrative showing that the TP analysis and results comply with the ALS. Simple assertions, conclusory statements and other unsubstantiated claims often seen in reports (for example, in the functional analysis section) are not likely to be accepted at face value without further supporting evidence.

2 Are there any key issues that local TP/Tax examiners are focused on in your jurisdiction?

Of course, the obvious issue has been the COVID-19 pandemic and the disruption it brought to the global economy. While for some clients this led to an upturn in their business – e.g., healthcare, medical device mfg., media/entertainment, consumer packaged goods, logistics services, personal technology, others – many others suffered severely. For example, many businesses in heavy manufacturing suffered significant losses from an unexpected buildup in unsold products. In some case, they've also suffered from an unexpected buildup in inputs, especially to the extent such inputs were purchased opportunistically when prices were favorable.

Because the economic disruption in 2020 has been so widespread and severe, the effects are often seen in benchmarking ranges, especially for ranges based on data from Q2. In many cases, this has lowered the burden of related party payments, especially in cases where the tested party's result must be trued up to lie within its relevant benchmark range.

Tax relief measures passed into law earlier in the year allow taxpayers expecting to report net operating losses in 2020 to carry back such losses to a prior year and, if in such prior year the taxpayer reported taxable income and paid taxes, file for a refund claim. The carryback period goes back as far as 2013. This is significant, because prior to January 1, 2018, the U.S. statutory tax rates were at higher levels.

Interestingly, this has led IRS officials to contemplate the extent to which relief measures benefitting domestic taxpayers creates a distortion for TP purposes. Temporary tax subsidies provided to domestic taxpayers are meant to promote the domestic economy and minimize local unemployment. Therefore, if a local company operates as a subsidiary of a foreign-owned parent and further, if the local company is the tested party in a TP structure, the question arises as to whether the TP test should be made according to its results *with* the subsidy or *without* it. It's easy to see that the tax authorities involved would have opposing views, because neither would want to be seen as effectively subsidizing the taxpayers in the other jurisdiction.

On a separate matter, IRS has issued statements indicating that APAs executed earlier which call for a U.S.-related party to record a financial result within a pre-defined range will not be open to re-negotiation. In

addition, IRS recently released guidance to significantly curtail the ability of taxpayers who have obtained a MAP or APA to reflect adjustments arising in one or more prior years from being aggregated, netted, and reported in a later year. Thus, at a time when businesses are struggling with severe operating losses, those taxpayers with executed APAs may have no or very limited ability to seek temporary relief.

Although the form of TP transactions of course matters (i.e., existence of legal agreements, administrative process, accounting records, etc.), the U.S. is for the most part a substance-over-form TP jurisdiction. This means that taxpayers will often find a receptive audience among IRS TP examiners so long as there is clear and convincing consistency with the underlying economic substance.

Having said that, the form is especially important in matters involving IP transfers and in particular, IP transfers executed according to a cost sharing arrangement (CSA). In such cases, taxpayers must pay careful attention to the detailed quantitative and administrative requirements as set forth under the regulations. Among the most consequential of TP cases litigated in the past several years are those involving IP transfers made according to a CSA. The key point at issue in those disputes involved the value of the pre-existing intangibles at the time of transfer. Further, in light of the IRS's losses in key court cases (e.g., Veritas, Amazon), Congress amended the TP statute in the 2017 Tax Cuts and Jobs Act (TCJA) to make it extremely difficult for outbound transfers of U.S.-owned intangibles to be motivated by tax benefits.

3 What can taxpayers do to best safeguard their TP positions in case of a future audit?

As mentioned earlier, when it comes to TP compliance, taxpayers should concern themselves not simply with having contemporaneous TP documentation but rather, with the quality of that documentation. Over the years it has become customary, for example, for a TP report to simply describe the taxpayer's operating facts, disclose the TP method selected, present the benchmarking range determined and compare the relevant financial result to that range. However, without a rigorously detailed and carefully written narrative, U.S. TP examiners are likely to view such report with skepticism and, as a consequence, deny penalty protection should income adjustments be applied.

For example, in the case of U.S. subsidiaries of foreign-owned parent companies, it is commonplace for examiners to assume that the group receives valuable contributions from its U.S.-based member. Further, it is commonplace to assume that such contributions rise to the level of being non-routine in nature (i.e., are intangibles). Thus, if that is not actually the case, taxpayers should make sure that local contributions are placed in proper context in order to preempt the examiner from adopting a false counter-narrative.

In addition, taxpayers should remember to prepare contemporaneous notes/memos to the tax file whenever appropriate/necessary to memorialize key facts, business decisions, uncertainties, intentions, etc. Doing so creates a factual record that is often helpful when, later on, it becomes necessary to recount how a certain decision/position was taken and the business reasons on which it was based. It is also helpful for the simple reason that internal personnel – e.g., process stakeholders, subject matter experts – may no longer be with the organization later on when an audit occurs. To a future IRS TP examiner, thoughtfully prepared contemporaneous file notes demonstrate a taxpayer's good faith effort to fulfill its compliance obligation and show respect for the future examiner's process.

In the case of MNEs where the local tax function reports to the local operating management team (i.e., instead of a centrally managed tax department at the parent company), a best practice is to draft, circulate and reach consensus on a TP process calendar. This document outlines the process steps, timing, and who the process owners are at each step or area of responsibility. Like anything process-related, efforts to create organization and structure promote collaboration and help minimize inefficiencies. ■

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