Briefing

Quarterly transfer pricing briefing

Speed read

Recent developments confirm the continued focus of tax administrations on transfer pricing compliance and adoption of country by country reporting, but the changes also illustrate the desire for some tax administrations to create a framework for increased certainty through the advance pricing agreement (APA) process. Among the developments, the US, Australia and Japan have confirmed that the OECD CBCR template will be followed for the required submission of information; the EU Parliament has proposed amendments to the EU administrative cooperation directive to include the sharing of key tax related information on multinational groups; and the EC announced a formal investigation into Luxembourg's transfer pricing rulings concerning a McDonald's franchising affiliate in Luxembourg.

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US, Australia, Japan and EU: country by country reporting announcements

On 17 December 2015, the Australian Taxation Office (ATO) issued documentation and country by country reporting (CBCR) guidelines (based on OECD standards), whereby multinational groups with global income exceeding AUS $1bn (US $750m) are required to submit annual country by country reporting (CBCR) statements.

On 23 December 2015, the US Department of the Treasury issued proposed regulations that require US parented multinationals with revenue greater than US $850 million for the prior accounting period to prepare CBCR documentation on an annual basis.

On 24 December 2015, the Japanese cabinet approved the 2016 tax reform package, including adoption of CBCR for all Japanese companies with consolidated revenue of more than Y100bn (US $850m) for fiscal years beginning on or after 1 April 2016.

These announcements all confirm that the OECD CBCR template will be followed for the required submission of information, including: related party and unrelated party revenue; profit before tax; tax paid and accrued; stated capital; accumulated earnings; employee numbers; tangible assets; list of entities and tax jurisdiction of residence and/or incorporation; main business activity per entity; and other relevant information. (See comments on OECD approved XML schema in What to look out for.)

On 27 January 206, the EU Parliament proposed amendments to the EU administrative cooperation directive to include the sharing of key tax related information on multinational groups. (The directive currently requires the automatic exchange of information among EU tax authorities regarding income earned by non-residents from interest, dividends and other data.) The European Commission (EC) is also due to propose legislation later in 2016 that will require public country by country tax and profit reporting by multinational groups. The EU already has country by country reporting requirements for multinational financial institutions, which were approved in the wake of the 2008 financial crisis.

Recommended actions

Many multinational groups parented in Australia, the US and Japan and exceeding the revenue thresholds are already looking at a dry run to populate the standard OECD templates, using 2015 actual financials to highlight key risk areas. The US Treasury announced on 22 January 2016 that it is considering whether to provide US groups with the option to file CBCR with the IRS in 2016, even though the proposed reporting requirement will not apply to most groups until after 1 January 2017. This would allow affected groups to push ahead with potential local requests for information.

Singapore: revised transfer pricing guidance

On 4 January 2016, the Inland Revenue Authority of Singapore (IRAS) issued revised transfer pricing guidance, in relation to:

- applying the arm's length principle when transacting with related parties, or for specific transactions, such as loans;
- maintaining robust transfer pricing documentation; and
- facilities provided under tax treaties to resolve transfer pricing disputes.

Companies are required to maintain contemporaneous documentation on an annual basis. The revised guidelines also require substantially more group level details, which should provide 'a good overview of the group's businesses'. Safe harbour thresholds for exemption from documentation are available, but are limited to situations where charges are:

- less than $15m in purchases/sales of goods from related parties;
- less than $15m in loans to/from related parties; or
- less than $1m for other types of transactions.

Recommended actions

Following revised legislation in January 2015 and the subsequent increase in transfer pricing audits, many groups with material operations in Singapore reacted by initiating local country documentation reviews to assist with the swift resolution of audits. It is likely that this trend will continue in 2016, with the revised guidance facilitating the process for local filing, by preparing in alignment with the IRAS prescribed format and process.

India and China: advance pricing agreement statistics

On 22 January 2016, India's Central Board of Direct Taxes (CBDT) announced that it had entered into seven more unilateral advance pricing agreements (APAs) with taxpayers. This takes the total number of APAs to 39 (38 unilateral and one bilateral), including sectors such as investment advisory services, software development services, IT enabled services and manufacturing.

The CBDT said that the APA scheme 'endeavours to provide certainty to taxpayers in the domain of transfer pricing by specifying the methods of pricing and setting the prices of international transactions in advance'.

The IRS confirmed in December 2015 that it would start accepting applications for bilateral APAs with India from February 2016.

China's State Administration of Taxation (SAT) announced on 22 December 2015 that it had signed nine APAs (relating to 2014), consisting of three unilateral and six bilateral agreements. The SAT also confirmed that most of the unilateral APAs had been concluded within the last two years, and the majority related to manufacturing.

Recommended actions

The APA process can be an important tool in the drive for transfer pricing certainty, particularly if companies are already under audit. These announcements are positive, given the significant number of multinational groups affected by transfer pricing audits in India and China in the past few years. Groups that have already filed a unilateral APA may wish to extend this to a bilateral APA, thereby taking advantage of the increased appetite for tax administrations to work together. Groups that are undergoing audits in these locations should consider the pros and cons of filing an application as a precautionary measure.

EU: state aid and transfer pricing

On 3 December 2015, the EC announced the opening of a formal investigation into Luxembourg's transfer pricing rulings concerning a McDonald's franchising affiliate in Luxembourg, McDonald's Europe Franchising (MEF). Specifically, the EC is investigating whether certain rulings issued by Luxembourg on behalf of MEF constituted illegal state aid.

The announcement of this new investigation comes in the wake of several high profile investigations of transfer pricing related tax rulings issued by EU member states. In October 2015, the EC took two of these investigations a step further by issuing a decision that Luxembourg and the Netherlands had granted illegal state aid to Fiat and Starbucks, respectively. The US has raised several concerns with the EC's investigations, including whether:

- US headquartered companies are being unfairly targeted;
- the EC has jurisdiction over tax treaties between the US and EU member states;
- the retroactive nature of the EC's rulings is appropriate;
- the settlement amounts in these cases should be deemed foreign tax credits from a US perspective; and
- the EC is overstepping its authority by requiring the taxation of deferred income that only the US is entitled to tax.

Recommended actions

A significant number of multinational groups have already started to review (and amend) their international structure to take account of commercial substance in major operating locations, such as the UK, Singapore and Switzerland. This is due to concern that historical agreements and rulings in place in these jurisdictions are now perceived to be less robust.

International: stock-based compensation

In December 2015, Altera Corporation filed a petition (31538-15) challenging the IRS on the issue of whether stock-based compensation (SBCs) should be included in a cost sharing arrangement. The company filed its petition on 18 December 2015, noting that the IRS based the income adjustments not on 2003 regulations but on temporary and permanent cost sharing regulations, adopted in 2009 and 2011 respectively. Altera argued that the requirements of all versions of the regulations are essentially the same and are invalid on the same grounds.

Recommended actions

Many groups are not including SBCs in cost sharing anymore, and have adjusted FY 2014 filings where they could avoid a secondary adjustment. Most point to the economic substance of agreements, stating that the parties only shared SBCs because the regulations said they were required to as a basis for application in FY2014. Many other groups are amending agreements with effect from FY 2015 to reflect this.

Certain groups have attempted to take a financial statement benefit for any potential claw back, as well as for the current year. Many, however, have elected not to take a financial statement benefit (it is up to each group to review and to articulate its position on a consistent and reasonable basis). Some groups have excluded SBCs from management charges (and applied the comparability standard, changed the mark-up basis and removed SBCs from the cost base).

The period for the tax court decision appeal will expire in February and it is likely that this will precipitate some further refinement of the treatment of SBSs.

What to look out for

The OECD will (and may already have done so by the time of publication) publish its XML schema for country by country reporting, with an associated user guide to facilitate uniform implementation. The XML schema is to be used for the automatic exchange of country by country reports between competent authorities and also for domestic reporting to local tax administrations.

Some of the key changes are as follows:

- If the reporting group has a tax identification number (TIN) that is used by the tax administration in its jurisdiction, such TINs are to be mandatorily provided.
- Including the postal address of reporting groups remains optional, although the OECD strongly recommends that it is provided.
- Terms such as 'stated capital' remain undefined. In the absence of further clarity, such terms should be interpreted in a manner that is sensible and consistent.
- The additional information element (table 3 of the OECD's recommended CBCR format) permits a brief explanation necessary for the understanding of the compulsory information in tables 1 and 2.
- Extensive guidance is provided on the ability and process for making corrections.

The negotiations between the European Council of Ministers and the European Parliament on the shareholders' rights directive and the proposal for public filing of country by country reporting information will continue into next month and beyond.

In addition to the above, look out for 2016 Budget statements that will provide an opportunity for tax administrations to clarify the approach to transfer pricing audits and compliance (e.g. India in February and the UK in March). ■

For related reading visit www.taxjournal.com

- EC investigation into Luxembourg's tax treatment of McDonald's (9.12.15)
- Transfer pricing: quarterly review of developments (Shiv Mahalingham, 18.11.15)