

Briefing

Transfer pricing review: Spring 2016

Speed read

The major change of interest relates to the XML Schema mechanism released by the OECD for the exchange of country by country information between tax administrations. This exchange of information (and how it will be deployed) has continued to be one of the main concerns multinational groups have about post-BEPS transfer pricing compliance obligations. On 12 April, the European Commission (EC) set out a proposal to obligate companies in the EU with consolidated turnover of €750m to report country by country (CbC) information on their own company websites and on a public business registry.



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This update sets out a summary of key changes to international transfer pricing guidance, regulations and case law that have occurred in the past few months.

CbC reporting announcements: exchange of information mechanism

On 22 March 2016, the OECD published a standardised electronic template for the automatic exchange of CbC reports, referred to as the CbC XML Schema. This presents competent authorities and tax administrations with an electronic format for coding and standardising information in the CbC report. The CbC XML Schema closely follows the format of previous publications from the OECD on CbC implementation (see the January 2016 transfer pricing update), with some additional items:

- If the reporting group has a tax identification number (TIN) that is used by the tax administration in its jurisdiction, the TIN is to be mandatorily provided.
- The inclusion of the reporting group's postal address remains optional, although the OECD strongly recommends that this information 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 (e.g. with regard to accounting treatment).
- The additional information element (table 3) 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 CbC XML Schema is designed for the automatic exchange of reports between competent authorities. (It is expected that tax administrations will be

required to translate CbC reports into the electronic CbC XML Schema.) However, the OECD guidance also states: 'The CbC Schema can also be relied upon by reporting entities for transmitting the CbC report to their tax administrations, provided the use of the CbC XML Schema is mandated domestically.' HMRC is planning to introduce a portal where groups can register to file the CbC report.

Recommended actions

Groups that are aware of their filing requirements should consider discussions with the tax administrations to explore electronic filing mechanisms that may reduce compliance burdens.

Groups that are unsure of their filing requirements should ascertain whether, when and where they need to file; and if there are obligations in more than one location, and/or obligations created by a lag in the ultimate parent location introducing the regulations when compared to surrogate parent locations. For example, the IRS regulations to implement CbC reporting are expected to be finalised by 30 June 2016, making the regulations effective for all tax years beginning after that date. There will therefore be a gap period between the US effective date on CbC reporting (30 June 2016) and the OECD proposed effective date (1 January 2016). As many foreign jurisdictions have already implemented CbC reporting using the OECD's recommended effective date, US based multinational groups face the reality that foreign jurisdictions may request their CbC report during the gap period, despite there being no formal requirement to file the US (at least in the interim period). A similar lag exists for Japan, where the regulations are relevant from April 2016.

US advance pricing agreement statistics

On 31 March 2016, the IRS issued advance pricing agreement (APA) statistics (following on from statistics issued by China and India earlier in the year). The statistics confirm that 183 APAs were filed in 2015 (127 of which were bilateral APAs). Almost 60% of the IRS APAs (and 75% of all its bilateral applications) continue to be with the NTA in Japan and the CRA in Canada. There has been some international interest, with the first bilateral APA being executed with Italy. The majority of applications continue to relate to manufacturing and wholesale/retail (over 80% of all applications). It is also interesting that only 7% of applications used the profit split method as the primary transfer pricing method.

Recommended actions

The APA continues to be an important tool for transfer pricing certainty with over 180 multinational groups filing applications with the IRS in 2015. However, the lead times in the US of almost 40 months will continue to dissuade multinational groups from following this course of action.

Budget day in Canada

On 22 March 2016, Canada released the 2016 Budget with the following transfer pricing changes:

- legislation to implement CbC reporting;
- legislation to implement the automatic exchange of CbC reports under the common reporting standard developed by the OECD;
- legislation to narrow the interpretation of the cross-

border anti-surplus-stripping rule in order to

- reduce tax-free cross-border distributions of capital;
- \$444.4m five year investment for the Canada Revenue Agency (CRA) to hire additional staff to combat tax evasion and tax avoidance; and
- \$351.6m five year investment to enhance CRA's ability to collect outstanding tax debts.

Recommended actions

The increase in allocated funds will, of course, lead to an increase in the number of and the intensity of transfer pricing audits requiring Canada to become a material risk location for many multinational groups.

Budget day in the UK

On 16 March 2016, the UK's Budget day occurred with announcements (in addition to dropping the corporation tax rate to 17% by April 2020) for the adoption of the OECD's revised, post-BEPS *Transfer Pricing Guidelines* into UK legislation. (Note that Actions 8, 9 and 10 have been referred to, but not Action 13.)

Recommended actions

UK guidance must be construed in a manner that ensures consistency with the OECD guidance. As such, this is merely a formal announcement to confirm what multinationals groups are already aware of through their ongoing compliance efforts.

Budget announcements in South Africa

On 24 February, South Africa's government issued a blanket statement in a budget statement that it will address the evasion of tax through 'transfer pricing abuses'.

Recommended actions

We are seeing an increase in transfer pricing audits in South Africa and the announcement may exacerbate this. It is advisable that groups with international operations pay close attention to transfer pricing arrangements that involve lower tax jurisdictions. (This will include the UK, for example, when compared to the South African statutory rate of 30%.)

International case law: Russia

On 4 February, Oriflame Cosmetics LLC lost a case in the Supreme Court (Ref: 305-KG15-11546) which ruled that the company had failed to give 'sound economic reasons' for entering into a royalty payment structure (in this instance, a franchise agreement between Russia and the Netherlands).

The Supreme Court upheld the Commercial Court's view that the company didn't provide enough evidence to support its business reasons for the transactions.

Recommended actions

Challenges of this nature are becoming more common across Europe. The case highlights some basic steps that multinational groups can take to help defend against similar challenges where possible:

- What is the commercial basis for the structure and payment flow?
- Are the terms appropriate?
- Support for the arm's length method and price.

Public CbC filings in the EU

On 12 April, the EC set out a proposal to obligate companies in the EU with consolidated turnover of €750m to report CbC information on their own company websites and on a public business registry. The public information would be restricted to company operations within EU member states with aggregate reporting for activities outside of the EU (as well as for locations identified as havens through a 'blacklist'). It is also proposed that, where a non-EU headquartered multinational has EU operations, this reporting obligation will fall on the subsidiaries or branches in the EU unless the non-EU parent chooses to report this information for the group as a whole. The changes have been proposed under a separate legal framework from tax legislation (these changes would require majority approval of 28 EU member states in the Council of Ministers, instead of unanimous consent, which is required of all EU tax legislation). Some member states (e.g. Germany) have insisted that they would not back the legislation, as it may endanger the competitiveness of EU companies and could raise legal issues with other countries. The EC press release confirms that 'this proposal for a directive is now submitted to the European Parliament and the Council of the EU and the Commission hopes that this will be swiftly adopted in the co-decision process. Once adopted, the new directive would have to be transposed into national legislation by all EU member states, within one year after the entry in force.'

Recommended actions

Any multinational group above the €750m turnover threshold with European operations may need to disclose sensitive information relating to taxes paid in key operating locations. A review of the 2015 footprint will be important in assessing risk areas with the opportunity to commercially restructure, downsize non-essential entities and/or update policies where required. Minimising detection risk (i.e. the risk that a transaction is selected for transfer pricing audit) with a measured policy can be as important, if not more important, than minimising adjustment risk (i.e. the risk that a transaction is not arm's length).

What to look out for in the next few months

Consultation on profit split methods

As announced on 15 March, an OECD working party will commence looking at the profit split method for pricing related party transactions and, in particular, at:

- selection of the most appropriate method;
- highly integrated business operations;
- unique and valuable contributions;
- synergistic benefits;
- profit splitting factors; and
- use of the profit split method to determine the transactional net margin method range and royalty rates.

This is at the early stages but there is an opportunity for interested parties to help to frame this important review.

Other items to watch

In addition, look out for more local country budget statements adopting (and departing) from international transfer pricing guidance. ■

 For related reading visit www.taxjournal.com

- ▶ International briefing for March 2016 (Chris Morgan, 23.3.16)
- ▶ Budget 2016: The impact on MNCs (Dominic Robertson, 17.3.16)
- ▶ Quarterly transfer pricing briefing: 2015/16 (Shiv Mahalingham, 3.2.16)