December 2017
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WTS Transfer Pricing Newsletter

Editorial

Dear Reader,

It is our pleasure to present to you the WTS Transfer Pricing Newsletter for December 2017.

During 2017, the global transfer pricing environment has changed dynamically. Many countries have already adopted and tightened their transfer pricing regulations based on the OECD recommendations and releases.

Therefore, in order to keep you up-to-date in this dynamically changing environment, our WTS Transfer Pricing Newsletter provides you with an update and overview on current developments in the transfer pricing area in eight selected countries.

We hope you will find this newsletter useful and we would appreciate your feedback and suggestions.

If you have any questions regarding any aspects of this newsletter, our experts within the global WTS TP team will be happy to answer any questions you may have.

Yours faithfully,

WTS Global Transfer Pricing Team

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Brazil

Adoption of the Resale Price Less Profit method on long-term agreements

Brazilian income tax legislation provides for specific rules on the taxation of revenues and expenses resulting from long-term agreements (agreements with a performance term longer than one year and with a pre-fixed price), according to which the company is permitted to account, on a monthly basis, for the corresponding costs and revenues based on the comparison between the incurred budgeted costs in relation to the total budgeted costs.

Thus, the rationale of tax ascertainment of long-term agreements involves the matching of revenues and expenses during the performance of the project, in which the amounts accounted for by the company in each period shall be proportional and related to the stage of the project. At the end of the agreement, the company shall perform adjustments resulting from any divergences between the estimated revenues and budgeted costs and the revenues and costs actually incurred. Therefore, such system does not result in any losses in tax collection.

However, we understand that Brazilian transfer pricing rules do not provide for the adoption of estimated costs and deemed net sales price for the purposes of calculating the benchmark under the Resale Price Less Profit ("PRL") method.

In the PRL method, the calculation of the benchmark uses the average of the sales prices as well as the share of the cost of the imported items in the total cost of the products sold.

As the taxable basis of income tax on long-term agreements is founded on budgeted amounts (revenues and costs), the adoption of PRL in cases involving long-term agreements may result in distortions in the calculation of the benchmark as there is no transfer pricing provision allowing for the adjustment of the benchmark after the confirmation of costs incurred and revenues ascertained by the end of the project. Therefore, as transfer pricing rules assume the use of the actual costs and revenues, PRL should not be adopted until the variables used in its formula (costs and revenues) are effectively incurred and, thus, should not be calculated using estimated or deemed costs/revenues.

In addition, Brazilian transfer pricing rules also establish that, for the purposes of controlling and calculating the benchmark, the analysis shall be performed individually for each product, right or service transacted.

Recently, the Administrative Court of Tax Appeals ("CARF") – second administrative instance – analysed a case involving a company focussing on vessels construction, in which the taxpayer defended the adoption of the PRL method only after the end of the contracted transactions. CARF, in turn, did not accept such argument, but the decision was favourable to the taxpayer as, upon tax inspection, the tax authorities made the transfer pricing calculations based on the vessels instead of the product imported on a case-by-case basis (Appellate Decision 1201-001.853 of 16 August 2017).

In view of the above and despite the fact that CARF understood in the aforementioned decision that the adoption of the PRL method should be made during the execution of the

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project, we understand that there are arguments to defend that the taxpayer may wait until the end of the project (when the costs and revenues effectively incurred will be ascertained) in order to perform the benchmark calculation of each good, right or service imported on transactions subject to transfer pricing controls and perform the corresponding transfer pricing adjustment, if any.

China

The developing APA programme

2016 marks the first year of China's 13th Five-Year Plan and features a series of tax reforms led by its tax organisation, State Administration of Taxation ("SAT"). SAT has exercised its strong support of and active role in BEPS action plans, notably in refining its APA workflow. For instance, as of 1 April 2016, all unilateral APAs concluded by China will be included in the tax data exchange framework.

Against the above background, SAT has issued the "Public Notice on Enhancing APA Administration" ("Public Notice 64") to replace the previous APA rule. Public Notice 64 has updated the conditions for APA applications and enhanced the post-APA monitoring mechanism, as summarised below:

1) Priority treatment is offered to APA applicants who have closed a TP audit, have scored a top tax credit rating, are seeking an APA renewal with no substantial change to their business, or have well prepared their value chain analysis and TP methodology proposal, etc.;

2) An APA application should include an analysis on location-specific advantages, such as location savings, market premiums and value chain analysis or supply chain analysis;

3) Additional steps for APA application are required. APA candidates have to go through pre-filing and analysis stages and obtain pre-approval before proceeding to the stage of concluding a letter of intent and submitting a formal APA application.

The new APA regulation has strengthened the tax authority's oversight over the APA process and imposed stricter requirements on compliance, cooperation and transparency.

So far, China has signed 84 unilateral APAs and 55 bilateral APAs in the past 12 years, with a considerable amount of bilateral APA cases still in progress. Having benefited from its experience, SAT is becoming more sophisticated in handling APA cases and is becoming more prudent, stricter and more efficient in reviewing APA applications. SAT expects that a normal APA process lead-time will be 12 months for a unilateral APA and 24 months for a bilateral APA.

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With more APA information being made public, SAT is showcasing its open attitude in welcoming APA applications and its endorsement of APA's contribution to lessening tax disputes. The current movement also reflects China's determination to resolve international tax issues and eliminate double taxation by improving transparency and TP practices.

India

India introduces the Final Rules on drawing up the Country-by-Country (CBC) report and Master File (MF)

The Finance Act 2016 had introduced Section 286 in the Income Tax Act (Act), providing for the drawing up of the CBC report and also amended Section 92D of the Act to provide for maintaining the MF. The Central Board of Direct Taxes has notified the final rules as regards drawing up the CBC report and MF on 31 October 2017. The key highlights of the final rules are as follows:

CBC Reporting

- **Applicability threshold:** Applicable to an international group with a total consolidated group revenue of INR 5,500 Crore or more in the accounting year preceding the reporting year. Telegraphic transfer buying rate on the last day of the accounting year has been provided for converting and calculating the threshold.
- **Who is required to draw up the report:** Every parent entity or alternate reporting entity, if resident in India, would need to draw up the CBC report.
- **Form prescribed:** The CBC report shall be filed under Form No. 3CEAD.
- **Contents:** The contents of required Form No. 3CEAD are the same as those recommended by the OECD BEPS Action Plan 13.
- **Intimation by a constituent entity:** An Indian constituent entity, of a non-resident group, shall notify the relevant tax authority as per Form No.3CEAC as to which entity of the international group shall draw up the CBC report. If there is more than one constituent entity in India, the non-resident group shall appoint a constituent entity which will notify the relevant tax authority as per Form 3 CEAE.
- **Date of filing:** The deadline for filing the CBC is the same as the deadline for filing return of income, i.e. 31 November. However, for accounting year 2016-17, the CBC may be filed on or before 31 March 2018.
- **Signing authority:** The rules require that the aforementioned forms are to be signed by persons eligible to verify the return of income under the Act.
- **Penalty:** Stringent penalties have been prescribed for non-filing of the CBC.

Master File

- **Applicability threshold and who shall file:**

  Part A – All constituent entities resident in India

  Part B – Every constituent entity of an international group, if:

  a. the consolidated group turnover of the international group for the accounting year exceeds INR 500 Crore; and

  b. the aggregate value of international transactions during the accounting year;

     i. as per the books of accounts, exceeds INR 50 Crore; or

     ii. as regards the purchase, sale, transfer, lease or use of intangible property as per the books of accounts exceeds INR 10 Crore
- An international group with multiple Indian constituent entities may appoint one constituent entity to file the MF.
- **Contents of the MF:** The contents provided for in the MF are in line with the OECD model template. However, there are a few incremental pieces of information required by the Indian tax authorities.

→ **Deadlines and Forms to be drawn up** as shown in the table:

Who shall file	Form to be filed	Deadline for FY 16-17	Deadline for subsequent years
Every constituent entity of the international group regardless of whether or not any *international transaction is carried out by it*	Part A of Form No. 3CEAA	31 March 2018	Deadline for filing the income return (i.e., 30 November)
Every constituent entity of the international group *which meets the prescribed threshold*	Part B of Form No. 3CEAA		
Where more than one constituent entity is resident in India, the *appointed entity shall notify* the relevant authority	Form No. 3CEAB	01 March 2018	31 October i.e., 30 days before the deadline for filing Form No. 3CEAA

→ **Penalty:** Stringent penalties have been provided for the non-filing of the CBC.

As regards the contents of the OECD template, the final rules in India require additional information to be kept/maintained in the MF. Therefore, it is of utmost importance that the MF prepared for the group is reviewed from the Indian tax perspective before the same is filed with the tax authorities.

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Latvia

Increased focus on transfer pricing is expected due to fundamental tax reform entering into force on 1 January 2018

As of 2018, a company's profit will be exempt from CIT and 20% CIT will be paid only when a company pays dividends or other payments with the aim of actual profit distribution. Since the taxable base should be divided by a coefficient of 0.8, the effective tax rate will be 25%.

In the new CIT system, the following payments will be considered to constitute the CIT base:

→ non-business costs, e.g. costs of employees' rest, cost of representatives' cars, fines;
→ interest payments to non-financial companies and individuals exceeding certain limits (i.e. thin capitalisation requirements; as of 2018 one existing restriction will remain – the debt ratio to equity capital is 4 to 1 and a new restriction will be introduced if the amount of interest paid exceeds EUR 3 million);
→ if a bad debt is written off;
→ transfer pricing adjustments;
→ liquidation quota.

It is important to note that loans to related companies will be comparable to the payment of dividends and will be subject to CIT unless they qualify for a specific exemption. The exemption applies to the following loans:

- loans with a principal amount not exceeding retained profits as on 31.12.2017;
- loans provided by parent companies to their direct subsidiaries;
- loans issued by a company to its foreign PE;
- agricultural or forestry cooperative society loans to its members for business activities;
- issued loans if there are no retained profits as at the opening balance sheet of the current tax year;
- loan amounts not exceeding the share capital as at the beginning of the tax year, minus the loans mentioned in the following three points;
- if loans issued do not exceed received loans from unrelated parties;
- short-term loans (12 months);
- social company's loans.

During the tax period (the tax period will be monthly as of 2018) when the loan is repaid, the company is allowed to decrease the CIT base by the amount of the repaid loan. The draft law provides that the tax administration will be entitled to assess loans issued in 2017.

Due to the specific features of the new CIT reform, the new CIT law is aimed at ensuring that taxpayers do not extract profits by means other than dividends, thus aiming to avoid CIT payment. Any TP adjustment found to be necessary by tax authorities will lead to CIT payable. Therefore, preparing proper transfer pricing analyses will become increasingly important as of 2018.

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In this respect, it should be noted that there will be changes as regards TP documentation requirements. Latvia has already introduced the country-by-country reporting regulations with the first reporting year being 2016. It is also planned (but not yet adopted by the Parliament) to introduce the Master and Local File requirements with respect to the TP documentation as of 2018.

Russia

Transfer Pricing Developments in Russia

Russian Transfer Pricing legislation is essentially based on OECD principles, with certain important deviations. The key deviations are as follows:

- **Ownership criterion regarding the definition of subsidiaries:** More than 25% (direct or indirect) in Russia and more than 50% according to OECD common requirements,
- **Benchmarking studies:** Rules for the benchmarking analysis are similar to the OECD recommendations but have some differences (for example, loss-making companies and companies with negative net assets are not admissible for comparability purposes),
- **Information Sources:** in Russia, a two-tier hierarchy is provided for. Official information sources of authorised state authorities – price agencies and Official publications.
- **Intra-group services:** there is no simplified approach such as, for example, a 5% mark-up for low value-added intra-group services. It is necessary to conduct a full analysis on these types of transactions.

- **Transactions with intangible assets:** there is no special guidance on these types of transactions.
- **Safe harbours:** According to Article 269 of the Russian Tax Code there is a price range for interest expenses for different currencies.
- **Advance Pricing Agreements (APAs):** Available only to high taxpayers. Not available for permanent establishments.
- **Downward adjustments:** Only valid if you increase the tax base.

As of November 2017, the Russian State Duma is considering a bill that requires the provision of three-tier transfer pricing documentation simultaneously with the bill on the automatic exchange of CbCR. It is expected that such law will come in force as of 2018. According to this law, organisations that are members of MNEs with a consolidated revenue of over 50 billion roubles should provide for three-tier reporting to tax authorities (country-by-country reports (CbCR), global and national documentation). Tax authorities will automatically exchange the CbC reports of such MNEs.

In accordance with such requirements, the three-tier documentation will be in line with the OECD approach. But the submission of such documentation does not exclude the obligation of the taxpayer to prepare national transfer pricing documentation in accordance with local requirements. Currently, the OECD format of the Local File does not cover all aspects of Russian Transfer Pricing requirements.

In addition, taxpayers who are members of the MNE will be required to submit the notification of participation in the MNE to the tax authority.

Also, the bill provides for the rules of participation of a foreign tax authority, if it is stipulated by an international Treaty of the Russian Federation, in exercising tax control in the Russian Federation (tax audit, tax monitoring), which can be carried out with the participation of such body upon its request in accordance with Russian tax code and the provisions of international treaties of the Russian Federation.

At the same time, the bill provides for the order of automatic exchange of financial information with foreign countries (territories) for tax purposes, specifically the automatic exchange of CBCRs. Terms such as "financial information", "financial services", "financial assets" are defined. The bill also describes the limitations of the use of the information contained in the CBCRs.

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Slovenia

Increasing tax assessment on transfer pricing

Since 2014, tax audits in transfer pricing in Slovenia have been carried out by the specialised department for transfer pricing, which operates within the tax audit sector as part of the main tax office. Taxpayers who are subject to tax audit in transfer pricing are selected based on the risk analysis. The nature and quantity of transactions with related parties are underlying factors for the risk analysis, supplemented by the following main criteria:

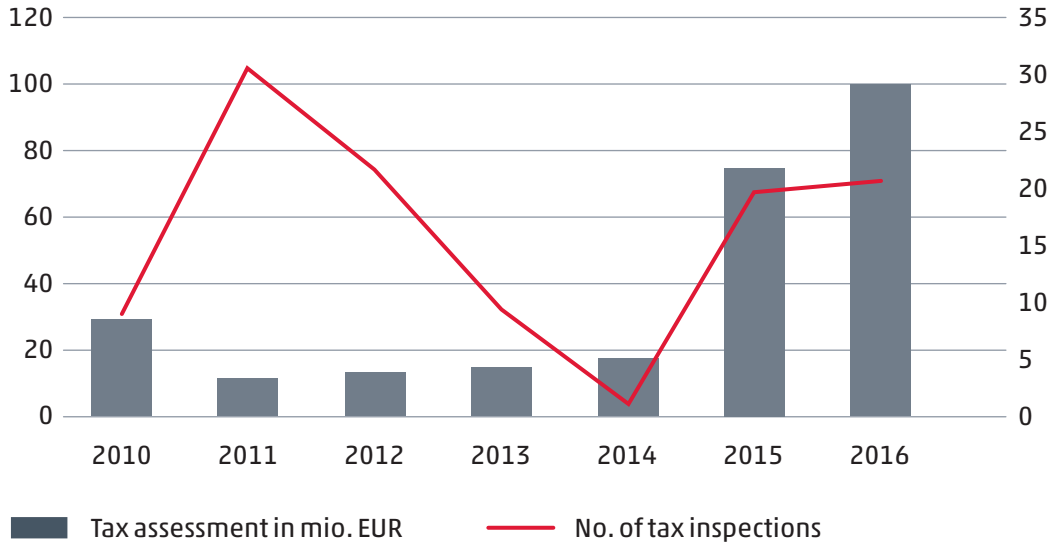
- long-term loss or profit, not reaching the average profit in the industry;
- thin-capitalisation;
- business relations with countries with favourable tax regimes.

Special attention in risk analysis is also attributed to permanent establishments, which do not assess and pay any corporate income tax and also taxpayers for whom tax risk was identified after the exchange of information with other countries.

The main irregularities in previous years on tax audits which contributed to the additional tax assessment were mainly from irregularities in connection with:

- thin-capitalisation;
- the attribution of profit to permanent establishments;
- payment for the use of licence fees and other intangible rights;
- invoices and credit notes used at the end of the tax year to adjust the tax base;
- marketing, management and similar services;
- inappropriate use of transfer pricing methods according to the facts and circumstances of a case.

The chart below shows that the number of tax audits before 2014, when the specialised group for TP was formed, were more often, but the additional tax assessment was low. After using the risk analysis to choose the taxpayers, the tax assessment rose significantly (source: Publication of FURS, Tax control of TP; August 2017).



Transfer pricing documentation is mandatory for all taxpayers in Slovenia. As early as at the time of submitting the tax assessment on corporate income tax, all taxpayers are obligated to submit an attachment detailing transfer pricing information, including the name, address and amount of transaction in the tax year with related parties, amounting to over EUR 50,000.

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South Africa

Summary of SA Local and OECD BEPS Transfer Pricing Compliance Requirements

Country-by-Country Report

Who must file? The South African ("SA") Country-by-Country ("CbC") Regulations only apply to Multinational Enterprise ("MNE") Groups with a total consolidated group revenue of more than R10 billion, or €750 million, during the Tax Year immediately preceding the Reporting Fiscal Year. For purposes of applying the €750 million threshold, the guidance should be taken into account that has been provided that, if a near equivalent amount in domestic currency of €750 million as at January 2015 is reflected in the CbC reporting legislation of the jurisdiction of tax residence of the Ultimate Parent Entity ("UPE") of an MNE Group, this near equivalent should be used. It must be noted that a member of a MNE Group resident in SA that is not the UPE of the Group may be required to file a CbC Report with SARS in certain specified instances.

When must it be filed? The CbC Report must be filed no later than 12 months after the last day of each Reporting Tax Year of the MNE Group beginning on or after 1 January 2016, which means that, originally, taxpayers with year ending 31 December were required to submit their CbC Report returns before 31 Dec 2017. However, SARS has granted an extension for such taxpayers to submit these returns by 28 February 2018.

In which format must it be filed? The CbC Report must be prepared in accordance with the OECD-prescribed XML Schema. The SA Revenue Service ("SARS") has indicated that the new system to upload CbC Reports, based on the Extensible Mark-up Language ("XML") Schema, would be ready on either 6 December 2017 or 15 Dec 2017.

Master File and Local File

Who must file? SA tax residents with an aggregate of potentially affected transactions for the year of assessment exceeding R100 million will be required to submit a Master File and Local File.

When must it be filed? The Master File and Local File returns must be filed by a taxpayer within 12 months from the date on which its financial year ends.

In which format must it be filed? The Master File must provide an overview of an MNE's global business model, specifically covering the organisational structure, description of the various businesses, intangible assets used in the businesses, intercompany financial transactions and financial and tax positions. The local file provides more detailed information relating to specific intercompany transactions and must be prepared in the format provided for in terms of the SARS Practice Note and relevant sections of the Tax Administration Act, 2011 (Act No 28 of 2011).

Documentation requirements for taxpayers below thresholds

Section 29 of the Tax Administration Act requires that where a taxpayer is engaging in a cross border connected party ("affected") transaction/s they must keep the records, books of account or documents that enable it to ensure and for SARS to be satisfied that the affected transaction/s is conducted at arm's length.

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Ukraine

New Draft Law on BEPS implementation

In September this year, the working group, led by the Ministry of Finance of Ukraine and the State Fiscal Services, finished preparing the new draft Law aimed at the implementation of TP-related Actions of BEPS into Ukrainian tax law.

The most important changes are as follows.

The draft Law adopts a three-tier approach to transfer pricing documentation according to Action 13 of BEPS. Namely, TP documentation shall consist of (i) master file, (ii) local file and (iii) Country-by-Country (CbC) report.

Suggested amendments are generally in line with basic BEPS recommendations. Yet, there are also some differences. For instance, although it envisages, in general, the BEPS compliant threshold of EUR 750 million for submitting of CbC Report, there are also specific rules designed for MNCs of Ukrainian origin.

Namely, MNCs with the annual consolidated group revenue equal or exceeding EUR 50 million would be obliged to file a CbC Report in Ukraine if one of the following conditions is met:

- the beneficial owner of the parent company of the international group of companies is a resident or citizen of Ukraine;
- ≥ 50% of shares in international group of companies belong to residents or citizens of Ukraine;
- ≥ 50% of the total number of employees of all companies of the group at the end of the reporting period are employed in Ukraine;
- ≥ 50% of the total balance sheet value of fixed assets of all group companies at the end of the reporting period are actually located in Ukraine;
- ≥ 50% of consolidated income of the international group of companies is income from sales of goods (works, services), the country of origin of which is Ukraine;
- if the parent company of international group of companies is registered in an offshore zone, included in the list, which is approved by the Cabinet of Ministers of Ukraine, and such company did not submit a CbC Report, or this report was submitted in the country which has not concluded an agreement on the exchange of information with Ukraine.

The draft Law also provides special provisions on the possibility to submit simplified TP documentation for low value-added intra-group services. This is the new provision not currently established in the Tax Code of Ukraine. Action 10 of the BEPS is the basis for provisions of the draft Law regarding such services.

An important novelty is the introduction of the principle of the business purpose of transactions. Namely, taxpayers will be obliged to prove in TP documentation that controlled transactions have a clear business purpose, which is actually the benefit-test.

According to the draft Law, controlled transactions are deemed to have a reasonable business purpose if, under comparable circumstances, an independent person is ready to

buy the same services or goods from another independent person in order to obtain the same benefits, or is ready to pay the same value of the services or goods. Otherwise (i.e. in the absence of a business purpose of a controlled transaction), the value of such controlled transaction shall be considered to be zero.

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The abovementioned novelty is going to make taxpayers feel themselves to be in a vulnerable position. Thus, the draft Law does not provide for the definite list of possible evidence of a business purpose of transactions. At the same time, the controlling authority is entitled to disregard, for tax purposes, the results of controlled transactions, which they believe not to have a "business purpose".

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