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# Asia Transfer Pricing

8th edition

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# Asia Transfer Pricing

INTERNATIONAL TAX REVIEW



*Unless otherwise stated, all information in this report is based on the tax regulations for the countries reviewed as updated on or after May 1 2016, or from KPMG member firm professionals' experience working with tax clients and tax authorities in their local countries.*

**INTERNATIONAL TAX REVIEW**™

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# The times they are a-changin'

By Tony Gorgas, **KPMG**'s Asia Pacific regional leader for Global Transfer Pricing Services.

The title to a famous Bob Dylan song written more than 50 years ago is quite apt with respect to capturing what is happening in the Asia Pacific (ASPAC) region in relation to the taxation of multinational enterprises (MNEs), particularly in the area of transfer pricing, and to the efforts of tax administrations to enforce the ever increasing rules and regulations in this area.

Historically, few ASPAC countries have been members of the OECD. The most recent ASPAC country to be admitted as a member was Korea in 1996. More recently, however, with changes to the global geo-political landscape and the advent of the G20 as the pre-eminent forum for global economic cooperation, large ASPAC economies such as China, India and Indonesia have played a more active role with respect to how the taxable profits of MNEs should be determined and how to counter multinational tax avoidance.

With the issue of the OECD's February 2013 report titled '*Addressing Base Erosion and Profit Shifting*', followed not long after by the OECD's '*Action Plan on Base Erosion and Profit Shifting*' (BEPS Action Plan), and the subsequent endorsement of the OECD's work by the G20, has come increasing realisation that multinational tax avoidance is a global issue that requires global solutions. As a consequence, the number of non-OECD and non-G20 countries participating in the OECD/G20's BEPS project has been increasing, including a number of non-OECD/non-G20 countries in the ASPAC region. This is shown in Table 1.

The increasing participation by non-OECD and non-G20 ASPAC countries in the technical work of the OECD/G20's BEPS project and by their tax administrations in international fora and in adopting mechanisms for exchanging information to enable them to more efficiently and effectively address multinational tax avoidance, is having far-reaching impacts in the ASPAC region. These impacts are rapidly and radically changing the transfer pricing landscape with potentially significant implications for MNEs operating in the ASPAC region.

### The OECD/G20 BEPS project will significantly impact MNEs operating in ASPAC countries

According to the OECD, international tax rules have revealed weaknesses that create opportunities for BEPS and estimates that the global loss of income tax could be between $100 to $240 billion annually. The losses arise from a variety of causes, including aggressive tax planning by some MNEs, the interaction of domestic tax rules, lack of transparency and coordination between tax

## Table 1

| ASPAC countries included in survey | OECD member | G20 member | Participating in Forum on Tax Administration (FTA) | Participation in OECD's BEPS-related technical work[1] | Signed Multilateral Competent Authority Agreement on exchange of CbCR[2] |
|---|---|---|---|---|---|
| | OECD Established 1961 | G20 Established 1999 | FTA Established 2002 | BEPS project launched 2013 | January 2016 |
| Australia | ✓ | ✓ | ✓ | ✓ | ✓ |
| China | | ✓ | ✓ | ✓ | ✓ |
| Hong Kong | | | ✓ | | |
| India | | ✓ | ✓ | ✓ | ✓ |
| Indonesia | | ✓ | ✓ | ✓ | |
| Japan | ✓ | ✓ | ✓ | ✓ | ✓ |
| Korea | ✓ | ✓ | ✓ | ✓ | |
| Malaysia | | | ✓ | ✓ | ✓ |
| New Zealand | ✓ | | ✓ | ✓ | ✓ |
| Philippines | | | | ✓ | |
| Singapore | | | ✓ | ✓ | |
| Sri Lanka | | | | | |
| Taiwan | | | | | |
| Thailand | | | | | |
| Vietnam | | | | ✓ | |

[1] Source: *Background brief: Inclusive Framework for BEPS Implementation*, OECD, March 2016.
[2] Australia, Japan and Malaysia signed on January 27 2016. China, India and Indonesia signed on May 12 2016.

administrations, limited country enforcement resources and harmful tax practices. In the OECD's view, this situation requires a bold move by policy makers to restore confidence in the international tax system and to ensure that profits are taxed where economic activities take place and value is created.

A key step in the direction of facilitating policy makers taking such a move was the issue of the OECD's final comprehensive BEPS package of 13 reports in October 2015 (OECD's final BEPS report). This package of measures was endorsed by G20 leaders at their November 2015 meeting in Antalya, Turkey. From a transfer pricing perspective, a key outcome of the OECD's final BEPS report was agreement on the need to introduce CbCR along with the associated Master and Local Files for large MNEs (ie those with global revenues exceeding €750 million ($830 million)) (Action 13 of the BEPS Action Plan).

As clearly shown in the country updates included in this survey, ASPAC countries are enthusiastically adopting CbCR irrespective of whether countries are members of the OECD or G20. As the following article shows, in May 2016, two-thirds of the ASPAC countries included in this survey have either already introduced, are in the process of introducing or have stated an intention to introduce CbCR, Master File and Local File.

### Conclusion

The increasing participation by non-OECD/non-G20 ASPAC countries in the technical work of the OECD/G20's BEPS project and by their tax administrations in international fora is likely to result in increasing convergence of approaches with respect to the taxation of MNEs, particularly in relation to transfer pricing.

The end result is that the transfer pricing landscape in the ASPAC region will continue to change.


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Tony's key strength is his leadership. He leads a number of transfer pricing projects in Australia and across the ASPAC region, and globally for key KPMG clients.

Tony has extensive contacts within the Australian Taxation Office (ATO). He is well experienced in negotiating favourable outcomes for clients, given his strong working relationship and reputation with the ATO's Senior Executives and Competent Authorities.

Tony has successfully concluded unique and valuable APAs (Advance Pricing Arrangements) involving business restructuring including resolution of collateral issues. He has concluded APAs on unilateral and bilateral bases, with key jurisdictions including Australia, US, UK, Japan, Korea, and he has valuable experience in the resolution of Mutual Agreement Proceedings between Competent Authorities.

# Asia-Pacific countries are enthusiastically adopting CbCR

By Tony Gorgas, **KPMG**'s Asia Pacific regional leader and Damian Preshaw, a **KPMG** consultant.

A key outcome of the OECD's final comprehensive BEPS package of 13 reports issued in October 2015 (OECD's final BEPS report) was agreement on the need to introduce CbCR along with the associated Master File and Local File for large MNEs, ie those with global revenues exceeding €750 million ($830 million) (Action 13 of the BEPS Action Plan).

Under CbCR, tax administrations will obtain a global picture of where MNE profits, tax and economic activities are reported. This information will enable tax administrations to assess transfer pricing and other BEPS risks better than ever before and therefore where to allocate limited compliance resources. The OECD's final BEPS report recommends that the first CbCR reports be required to be filed for MNEs' fiscal years starting from January 1 2016.

As Table 1 shows, in May 2016, two-thirds of the ASPAC countries included in this survey have either already introduced, are in the process of introducing or have stated an intention to introduce CbCR, Master File and Local File.

### Overview of CbCR, Master File and Local File

To summarise, large MNEs will be required to prepare and file the following documents:

- **A CbC report** that will provide a range of quantitative information annually and for each tax jurisdiction in which the MNE does business, including the amount of revenue, profit before income tax, income tax paid, number of employees, stated capital, retained earnings and tangible assets in each tax jurisdiction;
- **A Master File** that provides high-level information regarding the MNE's global business operations and transfer pricing policies to all relevant tax administrations; and
- **A Local File** that provides detailed transactional transfer pricing documentation specific to each country.

Annex III of the new Chapter V (Documentation) of the OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD TP Guidelines) contains the template for completion of the CbC report.

Annexes I, II and III of the new Chapter V (Documentation) of the OECD TP Guidelines contains details of the information to be included in the Master File, Local File and CbC report (including the template to be completed) respectively.

## Table 1

| | CbCR | Master File | Local File |
|---|---|---|---|
| Australia | ✓ | ✓ | ✓ |
| China | ✓ | ✓ | ✓ |
| Hong Kong | ✓ | ✓ | ✓ |
| India | ✓ | ✓ | ✓ |
| Indonesia | ✓ | | |
| Japan | ✓ | ✓ | ✓ |
| Korea | No announcement as at mid-May 2016 | ✓ | ✓ |
| Malaysia | ✓ | ✓ | ✓ |
| New Zealand | Presently considering if a law change is required or if the current law is sufficient to implement these new requirements | | |
| Philippines | No announcement as at mid-May 2016 | | |
| Singapore | ✓ | ✓ | ✓ |
| Sri Lanka | No announcement as at mid-May 2016 | | |
| Taiwan | ✓ | | |
| Thailand | No announcement as at mid-May 2016 | | Presently under the procedure of enactment |
| Vietnam | No announcement as at mid-May 2016 | | |

[1] Signed *Multilateral Competent Authority Agreement on Exchange of CbC reports* on May 12 2016

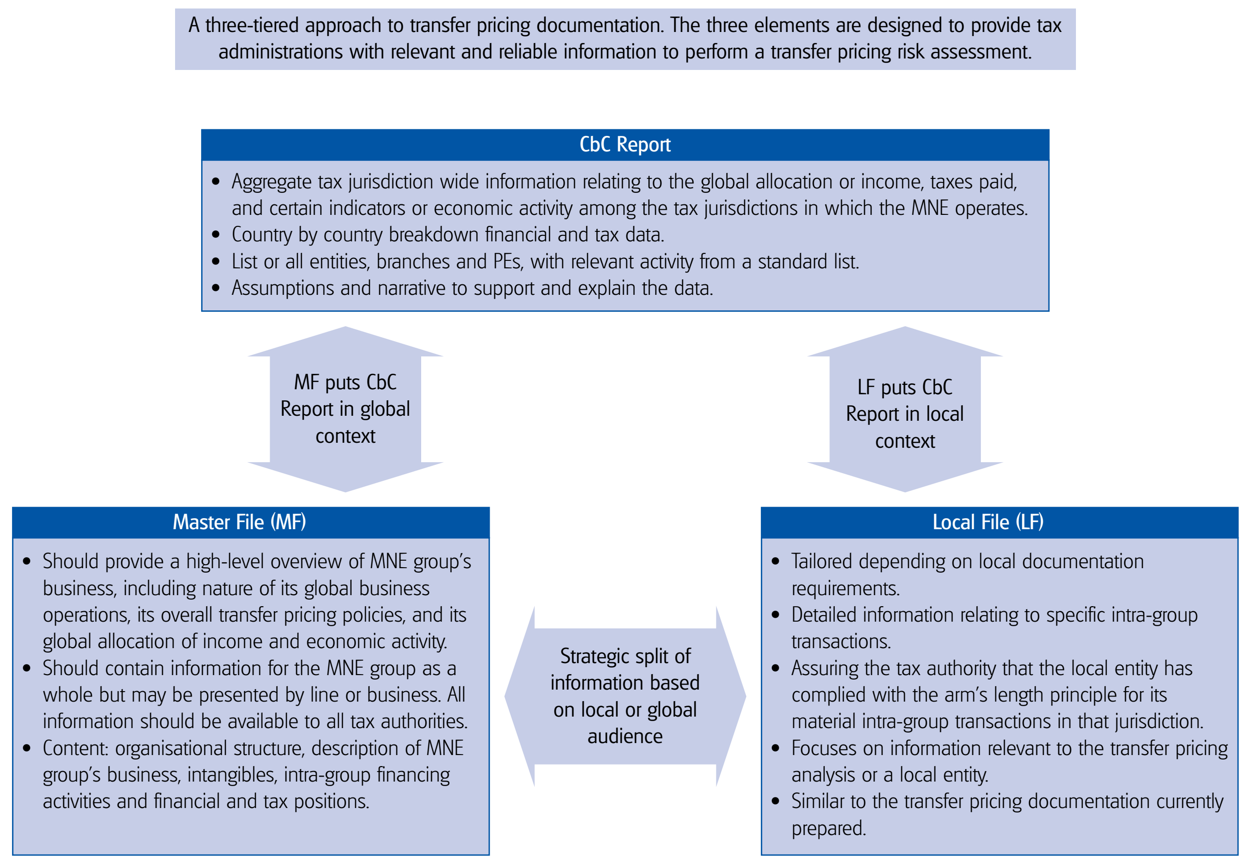
The underlying intention in requiring the above three documents to be filed is that they will require MNEs to articulate consistent transfer pricing positions and to provide tax administrations with useful information to perform transfer pricing risk assessments.

The interaction between the CbC report, Master File and Local File together with an overview of what is required to be included in each document is shown in Diagram 1.

### Potential implications for MNEs associated with CbCR

One of the underlying design features of CbCR is that the CbC report, once filed with the tax administration of the country in which the ultimate parent /reporting entity is located, will be automatically exchanged with tax administrations in other countries in which the MNE operates through mechanisms such as the exchange of information articles in double tax agreements and specifically designed

## Diagram 1




agreements such as the '*Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports*'.

A further design feature is that CbC reports are intended to be electronically transmitted between Competent Authorities in accordance with the CbC XML Schema developed by the OECD: see '*Country-by-Country Reporting XML Schema: User Guide for Tax Administrations and Taxpayers, Version 1.0 – March 2016*'.

The OECD envisages that the first exchanges of CbC Reports will commence in 2018, with information on the 2016 calendar year.

With respect to ASPAC countries surveyed that have already introduced, are in the process of introducing or have stated an intention to introduce CbCR, Table 2 shows the first income year to which CbCR will apply together with details of when the CbC report will need to be filed.

### Secondary (filing) mechanism

It is important to recognise that MNEs with their ultimate parent/reporting entity located in an ASPAC country, which may decide not to introduce CbCR or which may delay the introduction of CbCR can still be impacted by the introduction of CbCR in other jurisdictions. This arises due to a further design feature of CbCR which is that where a jurisdiction fails to provide information to another jurisdiction, for example, because it has not required CbCR from the ultimate parent/reporting entity of such MNE groups, a secondary (filing) mechanism has been developed whereby tax administrations in jurisdictions in which subsidiary members of the MNE are located can require filing of the CbC report directly with them.

Situations such as those described above could be fairly common in the first year or two of operation of CbCR as

## Table 2

| | 1st year to which CbCR will apply | Filing date for CbC report | 1st filing date for CbC report |
|---|---|---|---|
| Australia | Income years commencing on or after January 1 2016 | Within 12 months of end of period to which CbC report relates | December 31 2017 |
| China | Tax years beginning on January 1 2016 | | Likely mid to late 2017 |
| India | Financial year beginning on April 1 2016 | On or before due date for filing income-tax return (currently November 30) | November 30 2017 |
| Indonesia | Intention to introduce | No details as yet | |
| Japan | Fiscal year starting on or after April 1 2016 | No later than one year after the last day of the reporting fiscal year of the Ultimate Parent Entity | Reporting entity's fiscal (and tax) years beginning on or after April 1 2016) |
| Korea | No announcement as at mid-May 2016 although CbCR is expected for FY 2017 | | |
| Malaysia | January 1 2017 | No later than 12 months after last day of reporting financial year | December 31 2018 |
| New Zealand | Presently considering if a law change is required or if current law is sufficient to implement these new requirements | | |
| Singapore | Financial years beginning January 1 2017 | No later than 12 months from the last day of the reporting financial year | December 31 2018 |
| Taiwan | Intention to introduce | No details as yet | |

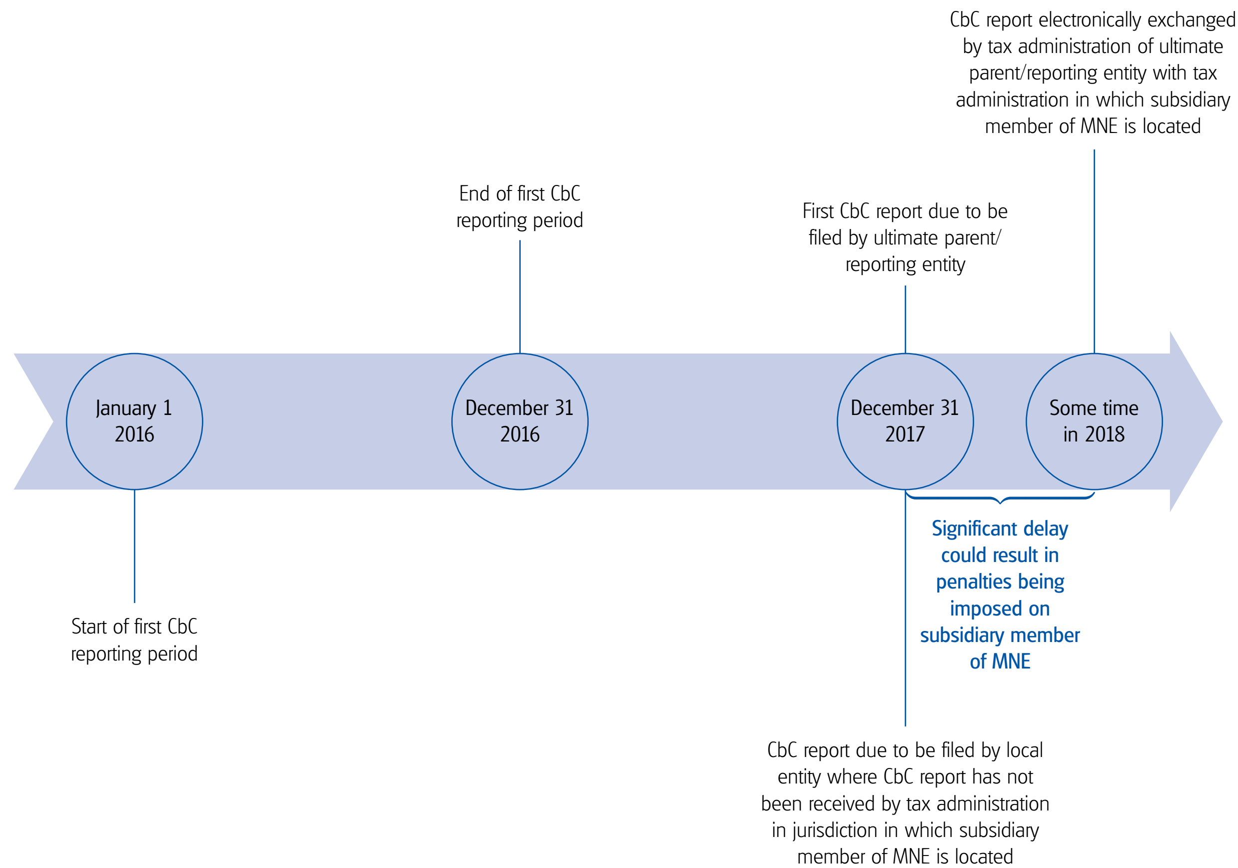
jurisdictions progressively introduce CbCR requirements together with arrangements for the automatic and timely exchange of CbC reports.

In such situations, it will be important for subsidiary members of MNEs to:

- Ascertain whether the MNE will be preparing a CbC report;
- Where the MNE will be preparing a CbC report – obtain a copy of the CbC report for filing by the due date; and
- Where the MNE will not be preparing a CbC report – maintain an open dialogue with the tax administration in the jurisdiction in which they are situated to ensure that it is aware that the ultimate parent/reporting entity of the MNE group is not required to prepare a CbC report, with a view to mitigating potential penalties.

We also envisage potential teething problems in the first few years of CbCR even in situations where the ultimate parent/reporting entity is located in a jurisdiction that has introduced a CbCR requirement. For example, delays could arise between the time of filing of the CbC report with the tax administration in which the ultimate parent/reporting entity is located and the provision electronically of the CbC report by that tax administration to the tax administration in the jurisdiction in which the subsidiary member of the MNE is located. Such delays could result in filing requirements falling on local entities

## Diagram 2




even though the ultimate parent/reporting entity has filed the CbC report by the due date. This is illustrated in Diagram 2.

In such situations, it will be important for subsidiary members of MNEs to:

- Confirm that the MNE will be preparing a CbC report and will be filing it with the tax administration in which the ultimate parent/reporting entity is located by the due date; and
- Maintain an open dialogue with the tax administration in the jurisdiction in which they are situated to ascertain whether the tax administration expects to receive the CbC report from the tax administration in which the ultimate parent/reporting entity for the MNE is located.

Given the likelihood that a secondary (filing) mechanism will be introduced in countries adopting CbCR, it will be important for MNEs to monitor and manage the filing dates for the CbC report in the various jurisdictions in which they operate. There are two key reasons to do so: first, filing dates for the CbC report may vary across jurisdictions; and second, penalties may be imposed for failing to file CbC reports by the due date in countries where a secondary mechanism has been introduced.

MNEs with operations in India should take particular care as the CbC report is due to be filed no later than the date the income tax return is due to be filed rather than within 12 months of the end of the period to which the CbC report relates which is the approach generally being adopted.

MNEs with operations in Australia should note that the obligation to file the CbC report is placed directly on an Australian member of the MNE rather than on the ultimate parent/reporting entity for the MNE. Nevertheless, once CbCR has been bedded down, it is anticipated that ordinarily the ATO would receive the CbC report from the tax jurisdiction in which the ultimate parent/reporting entity for the MNE is located.

## Table 3

| | Can a penalty be imposed for failing to file a CbC report? | Penalty that can be imposed | |
|---|---|---|---|
| Australia | Yes | A penalty up to A$4,500 [1] | |
| China | Yes | At least 10,000 RMB, or 10,000-50,000 RMB if the circumstances are serious | |
| India | Yes | Delay up to one month | INR 5,000 (USD75) per day |
| | | Delay beyond one month | INR 150,000 + INR 15,000 (USD230) per day |
| | | Continuation of delay after receipt of penalty order | INR 50,000 (USD 750) per day |
| Indonesia | Intention to introduce | No details as yet | |
| Japan | Yes | A maximum penalty of JPY 300,000 | |
| Korea | No announcement as at mid-May 2016 although CbCR is expected for FY 2017 | | |
| Malaysia | Yes | Amount not yet disclosed | |
| New Zealand | Considering if a law change is required or if present law is sufficient to implement these new requirements | | |
| Singapore | No announcement as of yet | | |
| Taiwan | Intention to introduce | No details as yet | |

[1] In the May 2016 Budget, the government announced a proposal to increase the maximum penalty to A$450,000.

### Penalties may apply for failing to file a CbC report by the due date

Given the added compliance burden that CbCR will impose, some MNEs may be wondering what the consequences of not preparing and filing a CbC report could be. With respect to ASPAC countries surveyed that have already introduced, are in the process of introducing or have stated an intention to introduce CbCR, Table 3 shows that penalties may be imposed for failing to file a CbC report and also provides an indication of the potential maximum penalty that could be imposed.

### Conclusion

The introduction of CbCR in particular along with the associated Master File and Local File for large MNEs arising out of the OECD/G20 BEPS project, will have significant and ongoing implications for large MNEs headquartered in or operating in ASPAC countries as a consequence of ASPAC countries enthusiastically adopting CbCR, irrespective of whether such countries are members of the OECD or G20.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Damian is a consultant to KPMG and is a transfer pricing specialist with more than 20 years' experience in both the private sector and with the ATO. Prior to establishing Damian Preshaw Consulting Pty Ltd in October 2015, Damian was a director in KPMG's Transfer Pricing Services Group in Melbourne for 12 years. In this capacity, Damian advised a wide variety of multinational clients on transfer pricing and profit attribution issues with a special focus on dispute resolution, financial services, financial transactions and business restructuring. Prior to joining KPMG, Damian was an international tax counsel in the ATO's Transfer Pricing Practice in Canberra and was an Australian delegate to the OECD's Working Party No.6 (Taxation of Multinational Enterprises) from 1994 to 2003. Damian is a member of the ATO's Division 815 Technical Working Group.

# When it rains it pours!

Frank Putrino, a partner at **KPMG Australia**, and Damian Preshaw, a **KPMG** consultant, look at developments in transfer pricing since 2012 and examine Australia's plans for further changes.

For a country as dry as Australia is, it is often the case that when it rains it pours! The same might be said of transfer pricing in Australia recently. Notwithstanding the introduction of retrospective interim transfer pricing rules in 2012 and new transfer pricing rules in 2013 and the passing of legislation in 2014 to require the ATO to release income tax information for corporates with total income of AUD100 million or more, further significant legislative changes were made at the end of 2015 that included:

- The introduction of a new Multinational Anti-Avoidance Law (MAAL) based on the first limb of the United Kingdom's recently introduced Diverted Profits Tax (DPT) to counter tax structures that are perceived to avoid the existence of a permanent establishment in Australia;
- The introduction of CbCR together with the associated Master File and Local File; and
- A doubling of penalties associated with transfer pricing adjustments for significant global entities (annual global revenue for the MNE is A$1 billion or more) in the absence of a Reasonably Arguable Position (RAP).

If the above developments weren't enough, the government recently proposed further changes to Australia's transfer pricing environment and to the ATO's administration thereof in the May 2016 Budget including:

- The proposed introduction of a new DPT based on the second limb of the United Kingdom's DPT;
- Adopting the OECD's new Transfer Pricing Guidelines;
- Significant increases in the maximum penalties that can be imposed on large MNEs;
- The establishment of a new Tax Avoidance Taskforce in the ATO with funding being provided for an additional 390 specialised officers; and
- New tax conditions imposed on foreign investment into Australia.

But wait, there's more! Throughout 2015 and continuing in 2016 there has been ongoing focus by the media in relation to the tax paid by MNEs in Australia or more accurately the perception that MNEs do not pay their fair share of tax in Australia. This focus has been fed at least in part by the Senate Economics References Committee's Inquiry into Corporate Tax Avoidance, and more recently by the leaking of the Panama Papers.

In October 2015, the Federal Court of Australia handed down its decision in the Chevron case which, amongst other things, is leading to a reconsideration of traditional transfer pricing approaches with respect to such fundamental transfer pricing issues as comparability.

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Prior to joining the GTPS practice, Frank was the Director & Counsel – Global Transfer Pricing for a Fortune 50 U.S. MNC for nine-and-a-half years where he was responsible for the design, development and implementation of transfer pricing strategy, policy, processes and documentation for the global operations of that MNC as well as Transfer Pricing Controversy (Audit Defence, Mutual Agreement Procedures & Advanced Pricing Agreements) across the Americas, Europe and Asia Pacific regions.

Prior to that, Frank was a Principal in a Professional Services Transfer Pricing team for 12.5 years and provided Transfer Pricing Planning, Compliance, Controversy and unilateral, bilateral and multilateral Advanced Pricing Agreements services to Australian outbound and inbound MNCs.

Frank has assisted a number of Australian and overseas based clients with their transfer pricing and global supply chain planning, compliance and controversy needs.

During his career, Frank has worked on a broad range of projects, and brings with him a wealth of operational and tax experience that can be applied across industries and jurisdictions. His experiences allow Frank to balance and recognise the synergies required among the business operations and tax teams, resulting in practical, commercial strategies that partner with viable transfer pricing solutions to complex business challenges.

And while all of the above has been taking place, the ATO continues to actively enforce compliance with Australia's transfer pricing rules.

A number of the above measures and proposals are covered in more detail below.

## Australia's reaction to the OECD/G20 BEPS project

Australia has been an enthusiastic supporter of the OECD/G20 BEPS project from the outset. It has also been an early adopter of a number of the recommendations arising out of the OECD's October 2015 final BEPS report. However, Australia is also taking unilateral action to address BEPS.

### Introduction of CbCR, Master File and Local File

Australia is one of the first countries to introduce CbCR together with the associated Master File and Local File. Legislation was passed in December 2015 with the new reporting requirements to apply to large MNEs for income years commencing on or after January 1 2016. The first documents to be filed are due by December 31 2017.

In Australia, it is important to note that the obligation to file the CbC report, the Master File and the Local File is placed directly on an Australian member of the MNE rather than on the ultimate parent/reporting entity for the MNE (although it is anticipated that ordinarily the ATO would receive the CbC report from the tax jurisdiction in which the ultimate parent/reporting entity for the MNE is located). Further, this obligation is additional to existing record keeping requirements in Australia's tax laws and to the transfer pricing recordkeeping rules in Subdivision 284-E of Schedule 1 to the *Taxation Administration Act 1953*.

To ensure compliance with the new reporting requirements, the May 2016 Budget announced a one hundred-fold increase in the maximum penalty from A$4,500 to A$450,000 for non-lodgement of tax documents with the ATO.

#### CbC report and Master File

The ATO has indicated that the approved form for the CbC report and for the Master File will follow Annex III and Annex I, respectively, of the OECD guidance on Action 13.

#### Local File

After a period of consultation, the ATO has recently finalised its requirements for the Local File and is now developing instructions to accompany the Local File which are planned for release mid-2016.

In Australia, the Local File is more focused on collecting entity and related party transaction data in an electronic form from which the ATO can run data analytics to identify potential transfer pricing risks. By contrast, the Local File in Annex II of the OECD guidance on Action 13 is more akin to traditional transfer pricing documentation.

In Australia, there will be two tiers of Local File: a 'Short Form Local File' for taxpayers with sufficiently small and/or low-risk International Related Party Dealings (IRPDs) – that will require only qualitative information regarding the local entity to be provided; and a 'Local File' for all other impacted taxpayers – that will require very granular information on IRPDs to be provided (Part A); and copies of written agreements, foreign APAs and rulings for 'material' IRPDs to be provided (Part B).

Large MNEs will need to pay specific attention to the unique Australian Local File requirements when implementing their global CbCR strategy.

### Adoption of new OECD TP Guidelines

As part of the May 2016 Budget, the government announced that the transfer pricing laws would be amended to give effect to the OECD's new Transfer Pricing Guidelines (arising out of Actions 8-10 of the OECD's October 2015 final BEPS report). The amendment will apply from July 1 2016.

### Unilateral action to address BEPS

Notwithstanding its enthusiastic support for the OECD/G20 BEPS project, Australia is nevertheless taking unilateral action that goes further than the recommendations in the OECD's October 2015 final BEPS report. The two key examples of this are the introduction of the MAAL at the end of 2015 and the May 2016 Budget announcement that Australia would introduce a DPT.

#### MAAL

The MAAL is designed to counter tax structures that are perceived to avoid the existence of a permanent establishment in Australia and therefore Australia having a taxing right over some part of the profits of the non-resident entity selling into Australia. The MAAL is an anti-avoidance measure and therefore is not subject to Australia's tax treaties. It applies from January 1 2016 irrespective of when arrangements within its scope were entered into. Further, where the MAAL applies, the base penalty amount is 100% in the absence of a RAP.

When the proposed MAAL was originally announced as part of the 2015 May Budget, it was portrayed by the government as being targeted at a small group of MNEs primarily operating in the information and technology sector. However, the ATO recently stated that 170 MNEs have either been approached by the ATO or have approached the ATO with a view to ascertaining whether the MAAL applies to them.

Recently, the ATO has expressed concern that some MNEs are entering into artificial and contrived arrangements to avoid the application of the MAAL: Taxpayer Alert TA 2016/2 (Interim arrangements to avoid MAAL).

#### Diverted Profits Tax

Given all the recent legislative changes in Australia, the government's May 2016 Budget announcement that a DPT would be introduced with effect for income years from July 1 2017 came as a surprise. The DPT is modelled on the second limb of the United Kingdom's DPT and is broadly targeted at arrangements with 'insufficient economic substance' between an Australian entity and an overseas related party that are taxed at a rate less than 80% of the applicable Australian tax rate. A new penalty tax of 40% will apply to the diverted profits with the tax payable upfront (interest will also apply). No grandfathering of existing arrangements is proposed.

Essentially, the objective of the DPT is to change the balance of negotiating power between the ATO and MNEs on transfer pricing and structuring issues. The May 2016 budget estimated additional revenue from the DPT to be A$100 million per year from 2018-19.

The government has issued a discussion paper in relation to the proposed DPT and has invited comments.


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### New Tax Avoidance Taskforce to be established in the ATO

A further announcement in the 2016 May Budget was the establishment of a new Tax Avoidance Taskforce within the ATO specifically targeting MNEs, large public and private groups operating in Australia as well as high wealth individuals. While the new taskforce brings together a number of existing compliance areas within the ATO, the ATO will get additional funding to employ an extra 390 personnel in the taskforce. The taskforce is expected to raise A$3.7 billion in tax liabilities over four years and is to be overseen by the Tax Commissioner and assisted by a panel of eminent former Judges.

### Litigation – The Chevron case

On October 23 2015, the Federal Court of Australia (FCA) handed down its decision in *Chevron Australia Holdings Pty Ltd (CAHPL) v Commissioner of Taxation* No.4 [2015] FCA 1092. The case concerns the transfer pricing implications of an intercompany loan between CAHPL and its United States subsidiary Chevron Texaco Funding Corporation (CFC) and whether the interest paid by CAHPL to CFC exceeded an arm's length price for the borrowing. The Court found for the Commissioner.

The case turned on the inability of CAHPL to satisfy the evidentiary burden imposed on it that the amended assessments were excessive (ie that the consideration paid was the arm's length consideration or less than the arm's length consideration).

While the decision related to Australia's previous transfer pricing rules, the decision has implications far beyond transfer pricing for intercompany loans:

- **Onus of proof:** In litigation, the ability of a taxpayer to discharge the onus of proof that amended assessments are excessive is critical.
- **Comparability:** Comparability is king! CAHPL could not show that the comparable uncontrolled transactions it used to support its position included similar terms and conditions to those of the intercompany loan in question and were therefore rejected by the Court.
- **Implicit support:** While implicit support is a relevant matter to take into account, the credit rating of the borrower is dependent on the facts and circumstances of the case. In this case, implicit support was found to have little impact on the standalone credit rating of CAHPL.

Chevron has appealed the decision and the appeal has been set down for a hearing at the end of August 2016.

## ATO compliance activity continues

The ATO continues to be active in enforcing compliance with Australia's transfer pricing rules. In addition to the ATO's focus in recent years on marketing hubs and inbound intercompany loans, the ATO has also recently issued Taxpayer Alerts in relation to arrangements involving offshore procurement hubs (TA 2015/5), leasing arrangements (TA 2016/4) and hedging arrangements involving loans and cross-currency interest-rate swaps (TA 2016/3).

In the context of ATO risk reviews and audits, recent information requests sent to taxpayers by the ATO are showing an increasing focus on questions relating to understanding where risks associated with particular activities are being managed, and how. The ATO is also seeking copies of contracts of employment for key Australian-based personnel and is using them as a sense check to corroborate responses received to questions relating to the management of risks.

The ATO has issued a number of new and revised practice statements on the following:

- Escalation process where reconstruction provisions to apply – PS LA 2015/3;
- Advance pricing arrangements (APAs) – PS LA 2015/4; and
- The interaction between customs and transfer pricing – PS LA 2016/1.

## Greater tax transparency

In parallel with changes to recent transfer pricing rules has come the introduction of new rules requiring greater transparency with respect to the tax paid by MNEs in Australia.

### Release of the first *Corporate Tax Transparency* report

In December 2015, the ATO released the first round of the *Corporate Tax Transparency* report for the 2013-14 income year for corporates with total income of A$100 million or more. The report contained information on 1,539 Australian public and foreign owned companies, noting the Australia Business Number (ABN), total income, taxable income and tax payable.

### Large MNEs required to prepare general purpose financial statements (GPFS)

From July 1 2016, large MNEs that do not presently do so will be required to prepare GPFS, rather than special purpose financial statements, and to provide these to the ATO by the due date for lodgement of the income tax. The ATO in turn, must give a copy of the GPFS to the Australian Securities and Investments Commission (ASIC).

## New tax conditions for foreign investments into Australia

The increased focus on transfer pricing and multinational tax avoidance more generally is having spill over impacts in other areas. For example, in May 2016, the Foreign Investment Review Board (FIRB) released new tax conditions that can be imposed on foreign investors wanting to invest in Australia, where it is considered that a particular foreign investment application presents a risk to Australia's income tax revenue.

The standard tax conditions include requiring foreign investors to:

- Comply with Australia's taxation laws in relation to the proposed investment;
- Comply with information requests from the ATO in relation to proposed investments; and
- Provide an annual report to FIRB on compliance with the conditions by the due date for lodgement of the income tax return.

Additional conditions may also be imposed on a case-by-case basis where a significant tax risk is identified. Such conditions could involve a requirement that the investor enter into negotiations for an APA with the ATO or seek a private ruling from the ATO. A failure to meet any of the conditions may result in prosecution, fines and/or the Treasurer ultimately ordering a divestment of Australian assets.

# A rapidly changing environment

Cheng Chi, a partner at **KPMG China**, examines the speed at which the Chinese State Administration of Taxation set out its plans for BEPS implementation and its view of BEPS.

## China – Local Environment

On October 5 2015, the OECD publicly released its '2015 Deliverables' under the G20/OECD BEPS initiative – a package of 13 reports with recommendations on changes to domestic laws and tax treaties which correspond to the 15 Actions of the 2013 BEPS Action Plan work programme. The BEPS initiative set out certain minimum standards, agreed between the countries participating in BEPS, as well as certain best practice recommendations, on improvements to domestic laws and tax treaties. These changes aim to enhance the integrity and fairness of the international tax system by realigning jurisdictional taxing rights with the location of 'value creation' and the place where business activities are actually conducted.

With an amazing response time, the Chinese State Administration of Taxation (SAT) held a press conference in Beijing on October 10 2015 to set out its plans for China BEPS implementation in advance of China's hosting of G20 and the Forum of Taxation Administration (FTA) in 2016. At the same time, the SAT also issued the Chinese language version of 2015 BEPS Deliverables.

In fact, China has already gone a long way towards localising the BEPS Deliverables as the SAT has issued a public discussion draft on Special Tax Adjustments (the Discussion Draft) on September 17 2015, deals with localisation of the BEPS work on Transfer Pricing (TP) and Controlled Foreign Company (CFC). However, China will not adopt all of the BEPS proposals and will naturally tailor them to China's circumstances and needs. The BEPS changes also occur in parallel with other tax rules, such as indirect offshore disposal rules and a rapid succession of new guidance is promised to come in the near future.

## China – View of BEPS and Local Updates for Advance Pricing Arrangements (APAs)

Action 14 of BEPS Deliverables set forth a minimum standard for resolution of treated-related disputes, together with a Peer Monitoring mechanism, falling under the FTA and Mutual Agreement Procedure (MAP) forums. This work will commence in 2016, with first reports due by the end of 2017. In addition, a group of 20 Western countries have committed to mandatory binding arbitration, with the mechanism to be developed in time for its inclusion in the multilateral instrument in late 2016.

The SAT has not accepted the mandatory binding arbitration under MAP proposed in Action 14. Nevertheless, the Discussion Draft refines

APA procedures and specifies the conditions where the Chinese tax authorities can prioritise and reject the APA application. Specifically, the Chinese tax authorities may prioritise taxpayers who provide complete application materials, include comprehensive and clear analysis on value chain or supply chain; consider location specific advantages such as market premium and location savings; and plan to adopt appropriate TP principles and calculation methods. Proactive cooperation by the taxpayers as well as strong focus and proactive attitude of the corresponding competent authorities would also be prioritising factors. The draft also clarifies the right of tax authorities to reject taxpayer's letter of intent, renewal application, or formal APA submission under different conditions.

It is also worth noting that the transactional volume requirement of 40 million RMB ($60 million) for APA applications is removed in the Discussion Draft.

## China – View of BEPS and Local Updates for Audit

Those proposed in the BEPS Deliverables have, among other factors, led to implementation of new domestic transfer pricing legislation, which will likely lead to differences in interpretation by individual countries.

On the other hand, the enhanced transparency measures under BEPS Deliverables, in combination with new mandatory disclosure requirements, enable tax authorities to scrutinise the allocation of global profits within MNEs.

From China's standpoint, this holds especially true in a transition period where localisation of the BEPS Deliverables in China can be best understood against the backdrop of China is becoming a net capital exporter. That said, while progressively more innovation is occurring in China, China still functions, within the global economic system, as a manufacturing hub; a very significant portion of foreign investment in China relates to processing trade. Therefore, SAT is of the view that they will continue to focus on strengthening application of source taxation rules. Changes to China's economic structure, movement by China up the global value chain, and changes to the nature composition and extent of Chinese investment in overseas will also be monitored, and if circumstances favour an adjustment in China's policies at the later stage, then the SAT would likely then consider this at that time.

## China – View of BEPS and Local Updates on Others

### Intangible Assets

It is worth noting that the Discussion Draft emphasises that in determining the value contribution of MNE group entities to intangibles assets (and the consequent TP profit allocation) emphasis is to be put on the 'middle value chain activities' frequently carried out by MNEs in China (eg, trail production, enablement of mass production) as well as China market building activities. As the OECD guidance would not consider these as the most important factors for intangibles value creation, divergent approach between China and other countries could ultimately lead to double taxation.

### New TP Method

In addition to the existing profit split method, a new Chinese Value Contribution Method is introduced under the Discussion Draft. The latter is supported by the comprehensive 'value chain analysis' section required in the Chinese TP local file (this appears to diverge from the documentation requirements under the BEPS Deliverables). These new measures exist in parallel with new extensive information requirement for outbound service payment arrangements and demanding tax deduction provision on outbound service/royalty payments. The Discussion Draft also notably excludes the BEPS proposed low-value service simplifications.

### Risks Attribution

Without any reference to the OECD's approach to 'properly delineating the transaction' by aligning risks attributions with effective risk control, and supplementing/adjusting contractual

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In addition to lecturing at many national and local training events organised by the Chinese tax authorities, Cheng has provided technical advice on a number of recent transfer pricing legislative initiatives in China. He is a frequent speaker on transfer pricing and other tax matters and his analyses are regularly featured in tax and transfer pricing publications around the world. Cheng has also been recommended as a leading transfer pricing advisor in China by the Legal Media Group.

risk allocation where necessary. The Discussion Draft in fact provides barely any reference on the weighting to be given to control of risks and relevant decision making in either 'delineating transaction' or in comparability analysis.

This is reflective of a long standing scepticism, borne out in the practical allocation of TP rules by the Chinese tax authorities, towards contractual allocations of risk which are considered to be susceptible to manipulation. To this extent, the omission of the BEPS refinements to the OECD's TP risk allocation approaches from the Discussion Draft perhaps reflects a continuation of this cautious approach, which focuses more on the performance of functions.

### Re-Characterisation

The new Chinese TP re-characterisation provision in the Discussion Draft applies to "related party transactions unlikely to occur between independent third parties under comparable economic conditions". While the BEPS guidance point out that the mere fact that a transaction may not be seen between independent parties should not lead to its rejection (the focus being on whether it is commercially rationale), it remains to be seen whether the Chinese tax authorities will take account of this in applying the re-characterisation provision in practice.

### Recommendations

Overall, China's rapid moves to implement the BEPS Deliverables truly put it in the vanguard among the countries of the world. The shape of the post-BEPS Chinese international tax rules is now emerging and MNEs should start to prepare for the tax risk management to fully cope in this new era of transparency.

# Transfer pricing is elevated to a new level

John Kondos and Lu Chen, partners at **KPMG in Hong Kong**, look at the rapidly evolving transfer pricing landscape.

Hong Kong is a key attractive location in Asia to establish operations for business. The economy is characterised by free trade, low taxation and minimum government intervention. It is a popular location for regional headquarters and it is an important banking and financial centre. Hong Kong has a source-based regime of taxation and while transfer pricing may have been less prominent in the past, the transfer pricing landscape in Hong Kong has evolved rapidly in response to the need of greater alignment to the international practices.

## BEPS implications

### Response to BEPS

On June 20 2016, Hong Kong accepted the OECD's invitation to join, as an Associate, the framework for implementing the recommendations of the OECD's final reports from the BEPS project. As an associate member, Hong Kong will work on an equal footing with the other countries and jurisdictions to implement the recommendations, including the four minimum standards (ie, in the areas of harmful tax practices, tax treaty abuse, CbCR requirements and improvements in cross-border tax dispute resolution). This announcement marks the government's first formal public action regarding the BEPS project and may be seen as an important step forward for the territory with respect to transfer pricing enforcement. However, formal legislative action and adoption of the BEPS recommendations by Hong Kong may be delayed, given the standard governmental process and a backlog of issues pending before the Legislative Council. It may be some time before the necessary amendments are approved.

### Other BEPS-related considerations:

Regardless of the timing of adoption of the BEPS initiatives by the IRD, multinational operations based in or with operations in Hong Kong will unavoidably be impacted by the transfer pricing-related initiatives one way or another.

#### Intangible property (IP) migration

Hong Kong is a centre of excellence for a number of research and development activities. In the past, for reasons including legal protection of IP, some companies with operations in Hong Kong set up entities in locations such as BVI to hold the developed IP. In light of the BEPS initiatives, leaving residual returns from the IP in an offshore company with minimum economic substance is not tenable. Corporations may need to consider

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He has completed a large number of Advance Pricing Arrangements (APAs), transfer pricing audit defences, as well as controversy management across Asia. He has extensive experience in transfer pricing documentation, planning, M&A due diligence, controversy, audit resolution as well as competent authority matters. John serves clients in a wide range of industries with a focus on financial services,

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Lu has led various types of transfer pricing engagements including transfer pricing documentation, planning and risk assessments in an M&A or IPO context, Advance Pricing Arrangements (APA), and transfer pricing audit defences for clients various markets including consumer market, retail, financial services, and technology industries. These clients include foreign multinationals investing in China as well as some of the leading Chinese or Hong Kong based companies making investments overseas.

She has contributed to numerous articles on China's transfer pricing in professional publications such as the *International Tax Review*, BNA Transfer Pricing Forum, and the A Plus Magazine. She is also a frequent speaker at both internal and external events on transfer pricing matters.

aligning the legal and economic ownership of IP and/or ensure appropriate economic returns from the IP go to the location with significant people activities. If the IP is migrated from BVI or similar locations, asset valuations for the historical IP may need to be considered. Alternatively, if the IP is retained offshore then the economic returns from the intangibles may need to be remunerated to the economic owner(s), through sub-licensing or other appropriate arrangements. An increasing number of companies in Hong Kong are addressing these issues and the appropriate approach should be determined on a case-by-case basis.

### Offshore tax regime

The practice of making offshore claims under Hong Kong's territorial tax system may increasingly come into conflict with transfer pricing. While there is a legitimate basis for companies to make an offshore claim in Hong Kong under particular circumstances, corporations will need to carefully consider how this may coincide with their transfer pricing policies. Corporations operating in Hong Kong will also need to consider how best to mitigate any potential exposures arising from these arrangements and consider the possible consequences from a wider group perspective.

### Value chain restructuring

The changes proposed by the BEPS Action Plans inevitably give arise to potential changes of tax outcomes for many taxpayers. With a key focus to align transfer pricing outcomes with value creation, there are increasing numbers of large companies with operations in Hong Kong taking this as an opportunity to revisit their current supply chain/transfer pricing model with an aim to explore an efficient BEPS compliant model.

## Maturing transfer pricing environment

### Increased transfer pricing enforcement

The Hong Kong IRD's increasing transfer-pricing enforcement has been seen in various industry sectors and the IRD is becoming more experienced with transfer pricing issues. The asset management sector has received particular attention but we have seen numerous transfer pricing queries and audit activities in a number of industries and at a transactional level. Service fee payments by taxpayers to their overseas head office or affiliates are under greater scrutiny. The information and supporting evidence requested by the IRD are very substance-focused and challenges are also seen on inconsistencies in the group allocation mechanism. Royalties and other transactions are also expected to be challenged more rigorously. While there is currently no mandatory transfer pricing documentation requirement in Hong Kong, the IRD in its transfer pricing audits expects to see robust transfer pricing documentation to support the relevant intercompany policies.

### APA development

The introduction of the Advance Pricing Arrangement (APA) programme in 2012 provided an avenue for the Hong Kong taxpayers to obtain greater certainty in today's fast changing tax environment. Since the introduction of the programme, Hong Kong has been actively expanding its treaty network and has entered into Comprehensive Double Tax Agreements (DTAs) with some 30 jurisdictions as of April 2016, which in turn helps to promote interest in applying for an APA. According to the IRD annual report for 2014/15, the IRD has received quite a number of applications in relation to DTA with different partners including China, Japan, Malaysia and the Netherlands. The first bilateral APA was concluded in 2014 and the second bilateral APA concluded in early 2015.

### Hong Kong to become a treasury hub

For companies looking to establish Corporate Treasury Centres (CTCs) in the region, and to position Hong Kong competitively it was proposed to allow under specified conditions, interest deductions under Profits Tax for CTCs, and to reduce the profits tax rate for specified treasury activities by 50%. Once enacted, it is expected that there will be an increase in intra-group financing activities through Hong Kong incorporated CTCs, such as cash pooling and other treasury-related support activities.

# A fresh look at transfer pricing in India

Rahul Mitra, Karishma Phatarphekar and Rajan Sachdev, partners at **KPMG in India**, examine India's steps for creating a taxpayer friendly environment and making the country a preferred destination for investments.

## Local tax environment

India has been consistently moving towards a non-adversarial tax regime. Efforts taken in this regard include measures to curb litigation on controversial matters such as transfer pricing treatment of issuing securities at premium and applicability of a minimum alternate tax levy to foreign companies.

The emphasis on the non-adversarial environment is aligned with India's commitment to have a stable and predictable tax regime in India, for both foreign investors and Indian taxpayers. The steps taken towards the simplification and rationalisation of taxation and reducing litigation are likely to have a far reaching impact on the transfer pricing litigation scenario in India. Some of the key developments (procedural as well as legislative) are discussed below.

- Introduction of the 'Range' concept and the use of 'Multiple Year Data': This is expected to help in reducing TP litigation since the comparability analysis undertaken using the 'arithmetic mean' and 'current year data' has been a contentious issue in India. Through this major change in the legislation, India has tried to align its transfer pricing regulations with international best practices. These provisions allow the use of preceding two years data and in certain circumstances, the use of range from thirty-fifth percentile to sixty-fifth percentile.
- Additional criteria for selection of cases for TP scrutiny: India's tax authority has issued new guidelines for the implementation of transfer pricing provisions relating to scrutiny/audits. These guidelines prescribe additional mandatory criteria to select transfer pricing cases and have replaced the 'Monetary threshold' based scrutiny case selection parameters with 'risk based' parameters. We believe that this step could result in the selection of fewer cases year on year for rigorous transfer pricing scrutiny by the field officer. The guidelines also provide clarity on the roles and powers of the Assessing Officer (AO) and the TPO.
- Faster dispute resolution through Advance Pricing Agreement (APA) and Mutual Agreement Procedure (MAP) route: India has put its APA and MAP programmes on the fast track. The subsequent section contains more details in this regard.
- Reduction in TP adjustments: Overall, the agenda of the present government to make the environment more taxpayer friendly has resulted in a much smaller amount of transfer pricing adjustments during the recently concluded transfer pricing audit round relating to FY 2011-12.

- Reduction in penalty rates: Recognising high penalties as the main reason for income-tax litigation, India announced a series of measures to reduce the penalty percentage and encourage taxpayers to settle disputes expeditiously. This includes reduction in the maximum penalty rate from 100-300% to 50-200% (The Finance Act).

Many areas for improvement do exist even in case of the above mentioned steps already taken for creating a taxpayer friendly environment in India. However, India's intentions are clear – making itself a preferred destination for investments and improving the ease of doing business.

## Update on Dispute Resolution Mechanisms – APA and MAP

### APA

India signed about 64 APAs until March 2016 and is learnt to have set an aggressive target during the FY 2016-17 for resolving issues through this route. A record 55 APAs were signed in the FY 2015-16 alone (*Government looks to resolve 100 transfer pricing issues, seeks to sign more advanced agreements: The Economic Times*). It is expected that some more complicated APAs will be signed during FY 2016-17. The APAs signed so far include bilateral APAs involving the competent authorities of other countries.

Also, It is now clear that the APAs have a persuasive value in the Indian courts of law and tax appellate tribunals. There have been instances where due weightage was given to the APA signed by the taxpayers for subsequent years. (Delhi High Court ruling in the case of *PCIT v. Ameriprise India Pvt. Ltd*. And Delhi Bench of Income-tax Tribunal's judgment in case of *Ranbaxy Laboratories Limited v. ACIT*). This will set a positive precedent for cases pending at the lower appellate authorities.

### MAP

MAP has also emerged as an effective alternative tax dispute resolution mechanism in India. In the last two years, India resolved 180 cases under this route. The total amount of income locked up in dispute in these cases was approximately INR 50 billion ($750 million.). The cases pertained to various sectors of the economy such as software services, IT-enabled services, manufacturing, consultancy services, etc. The countries with which cases have been resolved are U.S.A., Japan, UK and China, according to Government of India press release dated February 16 2016.

## BEPS

India, being one of the pioneers of the BEPS initiative, as part of the G20 countries, has already begun aligning its tax regulations with the OECD's BEPS report. The Indian TP legislation is being amended to include specific requirements in respect of CbCR and master file documentation with effect from April 1 2016. The CbCR provisions being incorporated in the law are broadly in line with the recommendations of OECD BEPS Action 13 report. Non-compliance with these reporting provisions will attract penalties. Some of the important aspects of India's CbCR provisions are discussed below.

### General

- In line with the recommendations contained in Action 13 of the OECD BEPS Action Plan, the following three-tiered TP documentation structure is being adopted by India:
  - Master file containing standardised information relevant for all MNE group members;
  - Local file referring intra-group transactions of the local taxpayer; and
  - CbC report, containing certain information relating to the global allocation of the MNE's income and taxes paid together with certain indicators of the location of economic activity within the MNE group.
- Master file to be maintained and filed in India. Information requirements are likely to be aligned with the BEPS Action 13.
- Local file related regulations that already exist in the Indian law may be aligned with the recommendations of the OECD which will require additional information to be maintained by the tax payer.
- CbCR threshold is to be aligned with the international consensus of €750 million ($834 million) which is indicated in general guidance. Official rules prescribing thresholds for Master file and Local file are expected in the near future.

### Compliance requirements

An Indian parent entity or Indian Resident Alternate Reporting Entity (ARE) of international group are required to file a CbC report in India, if the total consolidated group revenue exceeds €750 million, from FY 2016-17 onwards. It is expected to be file on or before the due date of filing for the Return of Income ie November 30 2017.

An Indian or Foreign parent entity including ARE may have to produce documents to determine the accuracy of CbC report.

### Implications

#### Implications for an Indian entity with a foreign parent (Inbound)

- An Indian entity with a foreign parent to notify Indian prescribed authority on or before prescribed due date, the details of parent entity or ARE, or whether it is the ARE
- The Indian entity may have to file CbC report if:
  - India does not have an agreement for exchange of the CbC report with the country of the foreign parent or ARE.
  - Despite having an exchange agreement, the country of the foreign parent or ARE fails to share the CbC report.

- Master file and/or Local file to be maintained subject to the Income-tax Rules.

Implications for Indian HQ entity (Outbound)
- The Indian parent entity is obliged to file the CbC report in India, subject to a revenue threshold as discussed earlier.
- Indian parent entity may designate ARE to file the CbC report.
- Master file and/or Local file to be maintained by Indian parent entity subject to the Income-tax Rules.

## Audits
As discussed in detail earlier, there are primarily two major developments which have happened in last one year in the context of transfer pricing disputes and audits. One is the government's agenda of having a non-adversarial tax regime, which has resulted in a lesser amount of transfer pricing adjustments. The other is the tax authority's circular clearly laying out the guidelines as to when a case needs to be referred for transfer pricing assessment, which has reduced the overall number of cases picked up for scrutiny.

## Other updates
### Foreign Tax Credit Rules
While India's tax treaties and the income-tax regulations contain broad provisions enabling tax residents to claim credit for the foreign taxes paid on income which is doubly taxed, there have been no specific rules laying down the manner of computation of such Foreign Tax Credit (FTC). This has led to uncertainties in claiming such credit and at times to litigation with the Indian Revenue. The Indian Revenue has taken steps to bring in certainty in this regard and has framed rules laying down the manner of computation of the FTC.

### Equalisation Levy
In order to tax e-commerce transactions of non-residents, an 'Equalisation Levy' is introduced in line with the recommendations of the OECD BEPS project.


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Rahul independently handles litigation for top companies at the level of Tax Tribunals & Authority for Advance Ruling. At least 50 of the cases independently argued by Rahul in direct tax & transfer pricing matters, have been reported in leading tax journals in India. Rahul has handled several APAs in India, involving clients from across industries, covering complex transactions, e.g. industrial franchise fees under non-integrated principal structures; contract R&D service provider model; distribution models, with related marketing intangible issues; financial transactions; profit split models for royalties; etc.

Rahul was invited by the OECD to speak at the 2012 Paris roundtable conference on developing countries' perspective on APAs and was also invited by the Indian Revenue Board in October, 2015 to provide training to transfer pricing Directors and Commissioners on the topic of marketing intangibles.

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Karishma is a Partner in KPMG in India's Global Transfer Pricing Services and litigation team. She is a core team member of the Global Dispute Resolution group and the national think tank group for tax in KPMG in India. She leads the transfer pricing litigation group and the dispute resolution group for Direct Taxation in the western region. She has over 18 years of work experience of which 14 years are focused on Transfer Pricing with extensive representation before the Transfer Pricing Officer (TPO ), the Dispute Resolution Panel (DRP) and/or the Income Tax Appellate Tribunal (ITAT).

Karishma has been nominated amongst the top ten transfer pricing advisors in India by International tax review. She was leading the transfer pricing practice for Grant Thornton in India and had been with them for almost 10 years. During her leadership their practice was voted as the best transfer pricing practice in India during three out of five years – World Finance (2009 and 2010) and Legal awards, in 2013. Karishma has advised more than 300 clients over her professional career span in Grant Thornton. Prior to Grant Thornton, Karishma has also worked in PwC for five years.

She is specialised in advising clients in the field of pharmaceuticals and Information Technology.

She has also written numerous articles and papers for the *International Tax Review*, BNA, Tax Analyst, Outsourcing, Economic Times, HBL, among others. Karishma has successfully argued high stake matters having complex TP issues before ITATs which are now binding precedents in law. She is also handling complex APA and MAP engagements and have been instrumental in concluding a recent APA for the ITES sector which has one of the lowest mark-ups agreed in India so far.

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Rajan believes his forte lies in closely understanding businesses, strategies and key management variables. Such understanding constitutes the core of any transfer pricing analysis and forms the basis for evolving meaningful economic analysis that is grounded in commercial principles. It is this ability that helped him to successfully lead a multi-jurisdictional x-los team to design and integrate a complex TESCM (tax efficient supply chain management) project for one of his clients, which also qualified as one of India's initial few integrated projects involving end-to-end solutions on in-sourcing of multiple manufacturing lines, vendor bases and supply chains.

# Will BEPS be a major game changer?

Iwan Hoo, a partner at **KPMG in Indonesia,** examines significant changes in the tax landscape and in transfer pricing practices.

## General introduction

The taxation landscape in Indonesia has been subject to significant changes over the past few years. Budgetary pressures have forced the tax auditors to be extremely thorough in their investigations and significant corrections have been made.

## Transfer pricing – general

The Income Tax Law (ITL) was introduced in 1983. Interestingly, the ITL back then already contained a provision that allowed for an adjustment to a commercial transaction (ie the transaction must be arm's length). This provision includes adjustments to income and expenses, and re-characterisation of debt as equity.

- The ITL defines a special relationship as:
- Capital participation of 25% or greater (direct or indirect);
- Control through management or technology; or
- Through close family relationships.

On September 6 2010, the Directorate General of Taxation (DGT) released guidance to taxpayers for the first time, with respect to their transfer pricing practices and related-party transactions. This regulation provides a general outline of the approach to be taken in determining whether the pricing of related-party transactions follows the arm's-length principle. The regulation covers the steps to be performed in demonstrating whether the pricing of transactions between related parties are in line with fair and common principles. These steps are:

- Performing a comparability analysis, including consideration of a functional analysis, contractual agreements, economic conditions, and business strategy;
- Determining the pricing methodology to be applied;
- Determining the 'arm's-length' price or range; and
- Documenting the process, satisfying minimum documentary requirements set forth.

The most recent guidance on transfer pricing was issued late 2011. These principles and concepts in these regulations are generally in line with the OECD Guidelines.

## BEPS

Indonesia is not a member of the OECD. However, it is a member of G20 and as such has been involved in the BEPS discussions. The Indonesian DGT has been active in socialising the concepts of BEPS by organising seminars with the consulting community, one being organised together with the OECD. Another indication of the relevance of BEPS was evident when Indonesia co-hosted a seminar late 2015 with tax policy and administration experts from 14 nations around the region in attendance. The Indonesian DGT has also stated on occasion that Indonesia intends to implement the country-by-country reporting concept. Moreover, the Indonesian Ministry of Finance has on several occasions mentioned that it intends to tax e-commerce by requiring these businesses to register as a permanent establishment, to incorporate a local entity or to enter into a joint venture with a local partner. However, no (draft) regulations on these topics, nor any of the other BEPS Action Items, has yet been released and it is not yet clear if and when the regulations will be introduced.

That said, Indonesian tax and transfer pricing regulations already include provisions regarding a number of the Action Items. However, these are not necessarily triggered by the BEPS initiative.

### Controlled Foreign Companies

Indonesia has strict Controlled Foreign Companies (CFC) rules for capital participations of 50% or more (with an exception for listed companies). The CFC regulations also apply when a dividend is deemed to be distributed and do not contain exemptions for subsidiaries with an active business or those who are not domiciled in a tax haven.

### Thin capitalisation

As recently as September 2015 Indonesia introduced thin capitalisation regulations which entered into effect on January 1 2016. The maximum debt to equity ratio is 4:1. Any borrowing costs relating to debts exceeding this ratio will not be deductible. The borrowing costs encompass not only interest, but also discounts and premiums associated with loans, additional fees incurred related to borrowing (eg arrangement fees), interest related to lease financing, guarantee fees related to debt, and foreign exchange differences.

### Counter harmful tax practices

Effective September 2018 Indonesia joined the Multilateral Competent Authority Agreement.

## APAs

In early 2015 the Ministry of Finance issued updated guidance on APAs. The guidance includes many formal requirements although these are generally in line with commonly accepted practices.

The application procedure starts with an initial meeting. In this meeting the full details on the taxpayer must be disclosed. It is therefore not possible to apply on a no-names basis to "test the waters". This initial meeting can become a series of meetings if the DGT requires more information. After the meeting the DGT will decide whether the taxpayer is eligible for the APA programme. If so, a full application must be submitted. If the APA application is successful, the taxpayer must submit annual compliance reports.

At this stage there are APA negotiations with a number of countries, both in the region and further afield. However, none have been concluded to date.

## Audits

The tax authorities are under immense political pressure to achieve revenue targets and even more so as in 2015 this target was missed by a wide margin. The tax auditors usually reserve most scrutiny for services and royalties.

For the intra-group services the discussion mostly focuses on the question whether services have been rendered and whether they were beneficial for the taxpayer. It is therefore detrimental to keep sufficient records of the receipt of the services and the benefit to be able to provide tangible evidence to the tax auditors. If a cost-based remuneration system is used any mark-up is not often the focus of the challenge.

Royalties, both for trademarks and know how, are also often under fire and even payments well-known brands of consumer goods are challenged and often end up in tax court. The main contentious issue is often the value of the brand and/or know how.

## Closing remarks

The transfer pricing landscape is still evolving in Indonesia since detailed guidance was only issued fairly recently and also the challenges by the tax auditors started just a few years ago. However, certainly at the level of the DGT there is awareness of the developments with regard to transfer pricing and BEPS


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Prior to joining KPMG Indonesia, he was with the KPMG Global Transfer Pricing Services group in Singapore for close to four years and the Netherlands for more than a year. Prior to that, Iwan was with the international tax group of another firm in Amsterdam and Jakarta for more than 20 years in total.

and various foreign advisors are assisting the DGT in taking the appropriate steps, although no tangible results are available as yet. However, we would expect that the DGT will soon issue guidance and regulations. The first topic to be addressed will quite certainly be the CbCR, but other Action Items may also be on the agenda.

Given the many challenges during tax audits, it is very important that taxpayers are able to defend their transfer pricing policies and having tangible evidence available is a must. And even if it is available it cannot be excluded that the tax auditors will impose significant adjustments which will take a lot of time and effort to challenge.

# Significant changes in Japan's transfer pricing landscape

Jun Tanaka and Nobuhiro Tsunoda, partners at **KPMG in Japan**, and Yosuke Suzaki, a senior manager, discuss the significant changes in Japan's TP documentation requirements, the influence of tax audits in Japan, as well as the implications of the tax governance rule for taxpayers.

Recent changes in the business environment and the financial situation of the Japanese government have affected the Japanese taxation environment and TP regulations. From the perspective of the taxation environment, especially with the significant increase of financial deficit and additional financial expenditure for the social security system with the rapid aging society, it becomes imperative for the Japanese government to increase its tax revenue. Accordingly, while the Japanese government is reducing the corporate tax rate for the purpose of maintaining the competitive edge of Japanese taxpayers, they also are expanding the taxation base, including the removal of tax deductions and to shift the tax base from direct tax to indirect tax (ie raise of the consumption tax rate). In the context of the above-mentioned Japanese government's efforts, the Japanese tax authorities also intend to ensure and increase the tax revenue. In particular, the Japanese tax authorities pay much attention to whether the taxpayers located in Japan report reasonable taxable income for their functions and risks as well as whether there are any unreasonable outflows of income to overseas countries.

From the business environment perspective, as more companies become multinational and international, the volumes of international transactions also increase. Particularly, many Japanese companies accelerate development in their business outside of Japan. According to the statistical data released by the NTA, the number of overseas related parties of Japanese companies almost doubled to 25,000 companies from 10 years ago. Especially, they have shifted functions such as manufacturing and sales or distribution overseas, though they still have high value added functions including R&D and strategy or planning functions at their HQs in Japan.

Japanese tax authorities are concerned whether Japanese taxpayers could be remunerated for these high value added functions and risks from overseas. Considering these situations, TP audits in Japan have strengthened more than ever, focusing on intangible transactions (ie royalties) and service transactions (including management service fee). This trend in strengthening the TP audits in Japan is expected to continue in future.

## Changes in tax audit and taxation

As a result of the shift in manufacturing and distribution functions from Japan to overseas, the number of out-out transactions conducted completely outside of Japan has increased. Consequently, the tax audit and tax assessment for such out-out transactions and intangible and service transactions have strengthened. For Japanese companies, many foreign related parties that receive any benefit from Japanese parent's intangible assets and services are located in BRICs and other Asian countries where Japanese companies have their manufacturing and distribution functions with no large volume of tangible transactions with their Japanese parent company. Therefore, Japanese tax authorities are highly interested in whether Japanese tax payers receive reasonable compensation from these overseas entities. Thus, the rapid increase in the number of tax audit and tax assessment for transactions with foreign related parties located in these countries are one of the major characteristics in the recent Japanese TP audit.

Additionally, the scope of tax audits and TP assessments has broadened. Although large enterprises have traditionally been the primary target of TP audits, it can be observed the target of TP audits has recently shifted to medium- and small-size companies including foreign companies' subsidiaries. According to "the outline of actual audit results for corporate tax and others" released by the NTA, the number of TP assessment cases was 240 in FY 2014 (the year ended in June 2015), which increased by 70 cases from last year. However, the TP assessment amount was JPY 17.8 billion ($173 billion), which was decreased significantly from the previous year (JPY 53.7 billion). As a result, the average TP assessment amount per case was below JPY 100 million (in FY 2014 it was JPY 74 million, but in FY 2013 the amount per case was JPY 320 million).

This situation indicates the big cases at multinational companies have already gone around and these large companies have taken preventive measures, most commonly TP documentation and advanced pricing agreement (APA), but medium- or small-size companies might neither take such measures nor have TP documentation. Another reason will be the change in TP and tax audit procedures. In Japan, transfer pricing audits had traditionally been conducted separately from corporate tax audits, and TP audits were made separately by a specialised transfer pricing audit team in a regional tax bureau. However, as the result of the tax reform in FY 2011, from January 1 2013, transfer prices have been audited as a part of corporate tax audit in principle. The corporate tax audit is regularly conducted, targeting not only large enterprises but also small- and medium-size companies. The increased number of target companies for transfer pricing audit will lead to the increase in the number of TP assessment cases and the decrease in the amount of TP assessments per case.

In addition to TP assessments, another major issue is that Japanese tax examiners often challenge to view the small amount of transactions as a donation to foreign related parties at regular tax audits. When a tax examiner finds that a transaction in which a taxpayer does not receive any remuneration or that the tax assessment amount is minimal in the process of tax audit, the tax examiner may try to regard it as a donation to foreign related parties. Similarly, some companies may be required to make voluntary tax adjustments. The survey of "Status of Field Audit for Corporations Engaging in Overseas Transactions" released by the NTA reports the number of tax assessment cases is 3,430 and the tax assessment amount is JPY 220.6 billion (including TP assessment) in FY 2014, which is significantly larger than the TP assessment amount as the statistics does not include any voluntary tax adjustment by tax payers. Thus, the actual number of cases and TP assessment amount resulted in double taxation in relation to the controlled transactions with foreign related parties will be considerably larger than those disclosed in the statistics by the Japanese tax authority. Considering these circumstances, the Japanese tax payers are supposed to surely take measures including TP documentation in order to minimise TP risk for related party transactions in advance.


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Jun advises various clients on transfer pricing audit defence, global transfer pricing documentation, implementation of transfer pricing strategies, global tax planning involving transfer pricing, planning on cross-border transaction schemes, and bilateral and unilateral APA discussions with tax authorities in Japan, the US, Germany and other countries.

### APA/MAP

In Japan, APA is one of the popular options to avoid potential TP risk and enhance predictability as well as transparency of taxation. Also, the tax audits in Japan are made periodically, and the level of tax audits are normally much in detail. The


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number of taxpayers who consider filing the APA in order to minimise the burden of tax audit in relation to transfer pricing areas, to avoid TP risk, and to strengthen their compliance with regulations have increased. APAs provide such merits to taxpayers, and thus the number of APA cases is increasing. The NTA also recommends applying bilateral APA as an effective way to improve predictability.

In FY 2014, the number of APA application increased to 121 cases and the number of cases closed were 100, with 330 cases still pending. Additionally, the covering countries taking part in the bilateral APAs have increased and been diversified, which is a recent characteristics of APA and MAP in Japan. As previously described, with increasing transactions with different countries, such as BRICs and other Asian countries, as well as increasing number of TP assessment cases in relation to the transactions with related parties located in such countries, the counter party countries of Japanese tax authorities at the Competent Authorities negotiation also has become diversified. Although the most major counter-party country is the US, followed by European countries such as UK, the number of APAs with Asia Pacific countries such as Australia, China, South Korea, Thailand, India, Indonesia, Singapore, or Hong Kong has recently increased. Considering these increases in APAs, the Japanese tax authorities enhanced their internal resources (eg number of employees) and expanded their network with foreign countries. Also, Japanese tax authorities have tried to gather information via information exchange schemes based on tax treaty. The number of tax information exchanges is about 300,000 each year for recent the several years.

## Aspect of BEPS on the Japanese transfer pricing regulations

Most of Japanese companies do not seek tax-saving scheme and tax planning proactively. They rather believe they have reported their taxable income appropriately. However, they have a strong concern about the BEPS argument. Among the 15 BEPS Action Plans, BEPS Action Plan 13 TP documentation is the area Japanese taxpayers are mainly interested in.

In order to solve international taxation issues including transfer pricing, Japanese tax authorities expressed the need to keep coordination with other countries tax authorities and have actually amended or newly introduced the related regulations reflecting BEPS Action items. The core is the rule for TP documentation in relation to the BEPS Action Plan 13. In Japan, there was TP documentation rule. However, not being a contemporaneous TP documentation, the old regulation listed the information, analysis and materials a taxpayer is required to submit when requested by tax authorities during a TP audit.

The new TP documentation rule based on the BEPS Action Plan 13 was introduced from (the FY starting in) April 1 2016. Under the new TP documentation rule, Japanese taxpayers are required to prepare and file TP documents (Master File and CbC report) within one year from the fiscal year end of the parent company in electronic format, and also to prepare the Local File by the timing of a taxpayer's tax return filing date.

Many Japanese taxpayers anticipate this new rule for TP documentation will increase significant compliance burdens beyond the level presently required, which will lead to additional compliance costs. Also, many companies are concerned that the filing information may lead to the streamlining of tax audit process and significant increases of TP audits in both Japan and other foreign countries, especially due to information described in the CbC report that is electronically filed and automatically shared with foreign tax authorities. Therefore, many companies have concerns of the increase in potential double taxation risk. The BEPS Action Plan 14 "Making Dispute Resolution Mechanisms More Effective" can help for solving double taxation issues, because the introduction of the clause for implementation of mandatory binding MAP arbitration in tax treaties has been discussed as a measure to solve international double taxation issues. The Japanese taxpayers desire the clause to be introduced, expecting that the clause for implementation of MAP arbitration will significantly promote MAP and lead to resolutions of conflicts. However, receiving approval by the parliament is necessary in order for the treaty to be effective officially, but the introduction of the clause for mandatory arbitration is not necessarily agreed among the participants of the BEPS projects. Therefore, some Japanese taxpayers raise concerns for such situations.

Considering these situations, it is necessary for Japanese taxpayers to develop their group's TP policy initiated by the parent company, to prepare TP documentation, and to check the status of TP documentation at their foreign related parties, as the minimum level of the countermeasures. Especially for the companies that do not have any TP documents, the introduction of the new TP documentation rule is assumed as a good opportunity for to the preparation of TP documentation.

# Get ready for the next wave!

Bob Kee and Mei Seen Chang, executive directors of **KPMG in Malaysia**, look at transfer pricing enforcement, business restructuring and BEPS, in this comprehensive examination of Malaysia.

The Malaysian Inland Revenue Board (MIRB) has in recent years placed great emphasis on transfer pricing enforcement activities on multinational companies. Malaysian companies are also not spared from scrutiny as transfer pricing issues might arise due to tax holiday or incentives enjoyed by certain local companies.

## Transfer pricing enforcement

In addition to the introduction of the transfer pricing checkbox in the Year of Assessment (YA) 2014 tax return form, taxpayers are required to declare whether or not contemporaneous transfer pricing documentation has been prepared for the relevant YA. The multinational tax department that oversees cross border transfer pricing matters, was converted into a Branch in January 2015, as the MIRB aims to consolidate all large or high profile taxpayers under the purview of this Branch, also known as the Large Taxpayer Branch. From this restructuring, the MIRB can focus its attention on the larger or higher profile taxpayers, as these companies' tax files will be directed to this Branch. In order to handle the increased enforcement activities, there was a redeployment of resources, especially in the field audit team.

## Transfer pricing audits and resolution

Based on the MIRB's 2014 annual report, tax collection has been on an increasing trend year on year, hitting a record high of Ringgit Malaysia (RM) 133.7 billion ($33 billion) in 2014. Table 1 depicts the upward trend of the MIRB's tax collection from transfer pricing audits in 2011 to 2014.

### Table 1: Transfer pricing audits resolved

| | Taxes and Penalties (RM million) | No. of cases resolved | % increases (in cases) |
|---|---|---|---|
| 2011 | 39.3 | N/A | - |
| 2012 | 116.4 | 78 | N/A |
| 2013 | 160.6 | 156 | 100% |
| 2014 | 156.6 | 160 | 2.56% |


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The number of transfer pricing audit cases resolved by the IRB in the year 2014 increased slightly to 160 cases, from 154 cases in the prior year, with a total tax collection of RM 156.6 million (inclusive of penalties). Though the official number of cases resolved in 2015 is not yet released, it is reported that the MIRB had collected a total of RM 111.8 billion in income tax in 2015, with a target collection of RM 118.5 billion for 2016, according to a news story published March 14 2016 in the *New Straits Times*.

Referring to the table above, the number of transfer pricing audit cases resolved by the MIRB in 2014 did not experience as sharp an increase compared to previous years. However, it has been increasingly challenging to resolve transfer pricing audits with the MIRB where taxpayers did not prepare its documentation or defences appropriately. As the MIRB tightens its efforts to ensure companies' compliance to transfer pricing rules, taxpayers who are unprepared or non-compliant would face an uphill battle during an audit by the MIRB.

Following the increase in transfer pricing audits, more taxpayers are also beginning to appeal through the judicial system – the Special Commissioner of Income Tax (SCIT) to settle their transfer pricing disputes with the MIRB. This might be due to an increased awareness and understanding of transfer pricing concepts amongst taxpayers, who might take the view that they would have a better opportunity to defend their case in the Malaysian Courts. The first level of appeal would be heard at the SCIT, following by the High Court and Court of Appeal.

As a result, the Dispute Resolution Panel (DRP) was set up by the MIRB in 2013 as an avenue for taxpayers to resolve cases before proceeding to the SCIT. The DRP consists of the MIRB's legal counsel who are independent of the transfer pricing audit officers in the MIRB. Through the efforts of the DRP, the MIRB hopes to be able to re-evaluate cases, with the hopes of coming to an out-of-court settlement with the taxpayer. This would in turn reduce the number of resources needed for a full-fledged legal suit. Since the setting up of the DRP, we have seen quite a number of disputes which are concluded by the DRP. This is a positive move by the MIRB to resolve cases before proceeding to the Malaysian court system, leaving those that ought to be heard and deliberated at the SCIT.

### Business restructuring activities

Given the fast changing global economy and corporations' efforts in maximising operational efficiency, there have been quite a number of corporations which have undergone business restructurings over the recent years. The movement of functions and risks from one related entity to another is a common business restructuring exercise, where large multinational corporations attempt to, amongst others, restructure its operations to minimise costs or improve operational efficiencies.

The MIRB is aware of this, and has been keeping a close watch. A sudden decline in profits, especially when the Malaysian entity has just come out of a tax incentive period would highly likely trigger an audit by the MIRB.

Whilst the MIRB would generally accept a corporation's restructuring exercise due to an economic or business reason, most taxpayers face difficulty in convincing the MIRB on the

## Table 2

| | Master File | | Local File | CbCR |
|---|---|---|---|---|
| **What?** | Overview of MNE group business | | Detailed information on inter-company transactions affecting local jurisdiction | Exchange mechanism: Automatic Exchange of Information (AEOI) IT Platform |
| **Who should prepare?** | Ultimate Parent/surrogate | | Subsidiary (Malaysia) | Parent (ultimate/surrogate) with a consolidated revenue of 750 million Euros and above as at January 1 2016 |
| **How and where to submit?** | Parent: Local Tax Authority | Subsidiary: Local Tax Authority | Subsidiary: Local Tax Authority | Parent: Local Tax Authority |
| **When to submit?** | 30 days on request (Malaysia) | | 30 days on request (Malaysia) | 12 months after end of fiscal year |

substance of the restructuring. More often than not, the business restructuring exercises would impact the profitability of the Malaysian entity, and the Malaysian entity is not able to substantiate to the MIRB's satisfaction that there has been changes to the functions and risks of the Malaysian operations, thereby impacting the remuneration it is entitled to. In cases which lacks substance, it is not surprising that the MIRB would challenge the legitimacy of the business restructuring exercise, especially when the profits are "shifted" out to a lower tax jurisdiction.

### APAs and MAP

The 2014 MIRB annual report states that seven cases of MAP were conducted which involved transfer pricing issues, interpretation and application of Double Taxation Avoidance Agreement (DTAA), technical fees and Bilateral APAs.

The MIRB has always encouraged the application of APAs, especially bilateral APAs as a tool for taxpayers to manage their transfer pricing risks rather than being engaged in time consuming transfer pricing audits. This is an option worth considering for taxpayers with large inter-company transactions with foreign related parties, especially when a business restructuring to the local operations has been planned. Taxpayers should take the opportunity to explore the feasibility of an APA as a tool to manage its TP risks.

### BEPS

Although Malaysia is not an OECD member country, the MIRB recognises the significant impact of BEPS on its tax base, and has been closely tracking BEPS Action Plan developments and voicing out its query and concerns as a developing nation. Over the last couple of years, Malaysia has been actively involved in selected BEPS working party and OECD meetings, and had also participated in the Subcommittee on BEPS for Developing Countries which was headed by the United Nations.

A BEPS Action Committee has been set up in the IRBM, which acts as the coordinating forum to discuss results from various BEPS meetings, suggestions or follow up on certain issues, implications on domestic law, as well as recommendations to the government, where applicable. Several round-table discussions with both taxpayers and tax consultants alike have been conducted to obtain feedback on the BEPS climate in Malaysia, and whether taxpayers are aware and ready for the changes to come.

Based on the questionnaire by the UN on Malaysia's experiences regarding BEPS issues, Malaysia has specifically identified the following as common profit shifting structures:

- Excessive or unwarranted intragroup payments such as interest on loans, management fees or technical services fees, or payment for intellectual properties;
- Global value chain models; and
- Mispricing of services rendered.

It is also interesting to note that Action 10 – Transfer pricing and other high risk transactions has been singled out as the most important Action Point for Malaysia in the questionnaire. This is consistent with the MIRB's comments during transfer pricing audits where the MIRB finds it difficult to accept that the transfer pricing outcomes are not in line with value creation (especially in the case of management fee payments).

Regarding reporting requirements, high level guidelines on how Action 13 would be applicable in Malaysia have been released by the MIRB. A summary of CbCR requirements for companies operating in Malaysia are presented in Table 2.

Though there are at present, many discussions revolving around Action 13 and how it will affect transfer pricing reporting in Malaysia, it is worthwhile to note that the MIRB is also placing a strong emphasis on Actions 8-10 (Intellectual Property (IP) and TP). IP and royalties have long been the topic of discussions and focus in transfer pricing audits, and it will be no surprise that the MIRB would delve deeper into these areas.

The MIRB has through various media releases and announcements stated that it will continue to closely monitor TP and BEPS developments, and will update and revise the Malaysian Income Tax Act to align with international standards, where relevant. Certain changes to the legislation have been proposed, and amendments to the Malaysian Transfer Pricing Guidelines as well as the introduction of CbCR Guidelines by the MIRB is expected to be released mid-2016. Although the MIRB acknowledges that the BEPS Action Plans may not be fully applicable in Malaysia, we foresee that the MIRB would largely adopt the concepts put forth by the OECD.

As preparations are underway for the implementation of CbCR in Malaysia, as well as the changes to the Malaysian TP Guidelines, we expect exciting and challenges times ahead as taxpayers, tax practitioners and the IRBM alike grapple with the concepts and practicalities of implementing CbCR.

# Inland Revenue's business transformation gathers pace

Kim Jarrett, a partner at **KPMG New Zealand**, looks at Inland Revenue's Business Transformation project which has wide-reaching implications for businesses and other taxpayers.

### Local tax environment

New Zealand has a coherent and mature tax system. A major overhaul of the tax system (eg to add new tax types) or a move away from the present broad-based and low-rate approach to taxation (ie the broad New Zealand tax policy settings) is not envisaged.

### Business transformation of Inland Revenue

Inland Revenue has started a significant Business Transformation (BT) project which will have wide-reaching implications for businesses and other taxpayers in relation to how they interact with the tax authority. The project is aimed at redesigning Inland Revenue's systems and processes for the 21st Century. Inland Revenue's focus is on greater use of technology to interact with businesses' processes (eg their accounting and payroll systems) to access information on a more "real time" basis, and also to communicate with taxpayers. BT will provide opportunities to streamline processes.

Consultation on key aspects of BT, including changes to the operation of New Zealand's PAYE and GST and business tax regimes, is underway.

### Other major tax policy changes

The New Zealand government has an 18-month tax policy work programme which encompasses a range of priority areas, including maintenance of the tax revenue base. The government is proposing and/or has introduced tax laws to:

- Simplify the business tax rules, including the penalties and interest rules and to introduce a new business income calculation method to support Inland Revenue's BT project;
- Widen the scope, and tighten the application, of New Zealand's withholding tax rules for non-residents;
- Tax investment in residential land, which is bought and sold within two years;
- Apply New Zealand's GST to offshore suppliers of services to New Zealand consumers; and
- Streamline the tax rules for closely-held companies and other owner-operated entities.

### BEPS

New Zealand is an active participant in the OECD's project on BEPS.

New Zealand's relatively robust taxation system means that not all of the BEPS action areas are likely to feature as priorities. Any proposals are likely to be subject to normal tax policy consultation processes. Issues which are likely to be relevant to New Zealand and its present status are:

- The Action 1 issues around taxing the digital economy. Non-resident suppliers of digital content (ie software and media) to New Zealand consumers will need to register for and pay New Zealand GST from October 1 2016 under a Tax Bill expected to be enacted early May 2016.
- The Action 2 recommendations are to combat hybrid mismatch arrangements. New Zealand already has some anti-hybrid measures (eg deductible foreign dividends are taxable, while certain hybrid financial instruments are re-characterised as equity to deny a deduction for payments). Further consultation on New Zealand's response to the Action 2 recommendations is expected in the second half of 2016.
- The Action 4 recommendations on interest deductibility. New Zealand already has thin capitalisation rules to deter non-residents from artificially loading debt onto their New Zealand business operations. These rules deny an interest deduction when the level of New Zealand debt gearing is greater than 60% (previously 75%) or is more than 110% of the worldwide group's debt gearing ratio. Recent changes have extended the application of the rules to New Zealand businesses owned by groups of non-residents "acting together". It is unclear whether further changes consistent with the OECD's recommendations will be considered. However, consultation on New Zealand's response is expected in the second half of 2016.
- The Action 5 recommendations on countering harmful tax practices and promoting greater transparency. New Zealand is a party to the OECD's Convention on Mutual Administrative Assistance in Tax Matters and has signed an Inter-Governmental Agreement with the US on the application of the US Foreign Account Tax Compliance Act (FATCA). New Zealand has committed to implementing Automatic Exchange of Information (AEOI) under the Common Reporting Standard (CRS) from July 1 2017. The NZ Inland Revenue will also start automatically exchanging unilateral tax rulings (including APAs) with treaty-partner countries in 2016.
- The Action 7 recommendations to prevent Permanent Establishment (PE) avoidance. To date, none of New Zealand's Double Taxation Treaties (DTAs) explicitly follow the OECD's recommendations (although some have provisions to create a PE where there is substantial negotiation of contracts). New Zealand is following with interest the OECD's ongoing work on attributing profit to PEs. New Zealand is also involved in the OECD's Working Party work on development of a multi-lateral instrument (Action 15) and the various transfer pricing recommendations (Action 8-10 and 13).


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At a broader BEPS related level taxpayers can expect:

- Changes to New Zealand's taxation of non-resident's interest income is expected (via a Bill to be introduced shortly). This will tighten the interest withholding tax and stamp duty rules applying to interest and interest like amounts; and
- An independent review of the disclosure requirements relating to New Zealand foreign trusts (trusts settled by a non-resident but subject to New Zealand law and with New Zealand resident trustees) is underway. The report is due to Government June 30 2016.

## APAs

Unilateral transfer pricing APAs remain popular and a cost-effective option for taxpayers to mitigate their New Zealand transfer pricing risk. Unilateral APAs are generally completed within six months of the date of acceptance of a formal application by Inland Revenue. KPMG's recent experience is there are some delays in scheduling pre-application meetings with Inland Revenue due to a large number of applications. On balance, however, a unilateral APA in New Zealand is generally a much quicker process compared to other countries.

With businesses and economic conditions evolving faster than ever, we are increasingly seeing breaches of APA critical assumptions. A breach of APA critical assumptions requires re-engagement with Inland Revenue to agree a suitable course of action. This may include termination and negotiation of a new APA.

## Risk reviews and taxpayer audits

Inland Revenue's compliance programme makes use of regular risk reviews of taxpayers. The risk review may cover specific transactions or particular areas of interest (eg financing, transfer pricing, or functional tax types such as GST or PAYE). A risk review may also lead to a more formal audit.

In KPMG's experience, Inland Revenue's risk focus has become more tailored and sophisticated over time. Transfer pricing has consistently been one of the focus areas of Inland Revenue scrutiny and a wide range of issues, including cross border financing, remuneration for use of intangible property and loss making New Zealand operations may be looked at. Although there are no transfer pricing court cases in New Zealand, we are experiencing an increased number of disputes going through formal dispute resolution procedures.

Inland Revenue also requires multinational companies with large New Zealand operations (ie turnover of more than NZ$80 million ($57 million)) to complete an annual international tax questionnaire as well as provide a Basic Compliance Package (comprising the tax return, detailed financial statements and a tax reconciliation to accounting) for its risk analysis purposes.

# Waiting again for the BIR

Maria Carmela M. Peralta, a partner at **KPMG Philippines**, looks at developments since the release of transfer pricing regulations in 2013 and examines the Strategic Plan for 2016 – 2020.

Since the release of the Philippine Transfer Pricing (TP) regulations in early 2013, the Bureau of Internal Revenue (BIR) has repeatedly stated, although informally, that it would be issuing additional guidelines to implement the regulations. The regulations would supposedly cover the preparation of the TP documentation, Advance Pricing Agreements (APAs), and conduct of TP audits. However, to date, the BIR has not yet issued the additional guidelines. This is not new considering that it took years for the BIR to finalise the TP regulations after releasing its draft. This may just be due to the capacity-building measures the BIR is taking. Further, the BIR has not even indicated whether it would work for the enactment of legislation adopting the BEPS initiatives of the OECD.

## Strategic Plan for 2016 to 2020

Nevertheless, TP remains to be on the BIR's radar screen. On February 15 2016, the BIR issued Revenue Memorandum Order (RMO) No. 06-2016, which outlines its Strategic Plan for 2016 to 2020 (the Strategic Plan). The Strategic Plan provides for the five-year overview of the seven high-level strategic objectives of the BIR to attain collection targets and sustain collection growth. One of the objectives is to improve assistance and the enforcement processes of the BIR. Under this objective, the BIR aims among other things to establish the approach to TP to address base erosion and profit shifting and the challenges of the digital economy and global business structures; to identify the required skills and expertise, reporting requirements, organisational arrangements, APA and Mutual Agreement Procedure (MAP) processes, and documentation requirements; to strengthen the focus on international tax risks; and to develop a methodology to identify and audit high risk companies that shift profits offshore or avoid tax obligations.

## Priority programmes for 2016

Aligned to the Strategic Plan is the priority programme for 2016 of the BIR as provided in its Revenue Memorandum Circular No. 14-2016, dated February 15 2016. The priority programme includes TP, specifically the subscription to a commercial database for TP studies, the development or pursuit of what it calls a TP test case for the BIR's Large Taxpayers Service (LTS), and the crafting or finalisation of TP-related issuances.

## Possible impact on taxpayers

One cannot gauge whether the BIR may in the near future implement its priority programme for TP. However, the BIR's TP team is known to have been discussing lengthily with a service provider of a TP database used extensively in other tax jurisdictions for regional or Asia-Pacific searches. This could indicate that the BIR may be willing to accept regional/Asia-Pacific searches. This is contrary to the often-mentioned preference of the BIR for local comparables. Nevertheless, it is still advisable to state in the TP documentation sufficient justification for the use of regional comparables.

Moreover, following the previous statement of the BIR on its preference for local comparables, many taxpayers have resorted to local searches. Admittedly, local searches raise questions on the quality and availability of data used for arriving at the set of comparables and for calculating the arm's-length range. But such searches have usually provided low-end arm's-length ranges compared to results from regional searches. As part of their own 'strategic' planning, taxpayers may consider conducting regional searches to check differences in the results between local and regional searches and see how adopting the regional searches impact on their financial results.

As the members of the BIR's informal TP team are also members of its LTS, one should not be surprised about the BIR's pursuit of a TP test case for the LTS. The LTS is the unit of the National Office of the BIR having jurisdiction over taxpayers classified as large taxpayers and notified to be such by the Commissioner of Internal Revenue. The classification is based on certain criteria with respect to amount of tax payments made (whether income tax or other types of taxes), amount of gross sales/receipts, or net worth. The number of candidates for the test case could be higher since under the Strategic Plan, the BIR aims as well to expand progressively the coverage of the large taxpayer base and strategically locate the LTS in key revenue regions. Any taxpayer should annually assess if it is about to meet the criteria to be classified as a large taxpayer and if it does so, it should consider having TP planning or TP documentation. Of course, a taxpayer already classified as such is a likely candidate and should attend to its TP concerns. The TP test case is most likely a long, drawn-out investigation.


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## Focus on collection

The BIR's Strategic Plan and priority programmes are for the BIR to attain collection targets and sustain collection growth. In fact, the first of the seven high-level strategic objectives under the Strategic Plan is to attain collection targets and sustained collection growth. And the BIR admits that this objective is dependent on achieving the other objectives under the Strategic Plan. The goals of the OECD's BEPS initiatives may not even be the focus of the BIR. The BIR may consider itself to be in a catch-up stage with respect to BEPS or even TP in general.

# Transfer pricing cannot be ignored … any more

Geoffrey K. Soh, a partner at **KPMG in Singapore** and Felicia Chia, a director, examine Singapore's dynamic and evolving tax environment including the new transfer pricing updates in January 2016.

## Evolving tax environment

The tax environment in Singapore is dynamic, in order to be in step with international developments. IRAS has put in place various requirements and guidance, to ensure taxpayers are able to defend their current structures under the spotlight of BEPS. Over the past 18 months, IRAS has undertaken a series of consultations with selected stakeholders, to obtain in-depth feedback on the extent that taxpayers are ready for BEPS Action 13 requirements, in particular CbCR.

## New requirements

2015 was a watershed year for transfer pricing compliance in Singapore. Following the release of expanded IRAS transfer guidance in January 2015, taxpayers were required to have Singapore-specific documentation in place before November 30 2015, the due date for tax returns for the 2014 financial year (December 15 2015 for e-filing). In tandem with the foregoing, there has been a notable increase in the number of transfer pricing queries and requests for documentation from IRAS. Generally speaking, IRAS' transfer pricing guidance echoes OECD principles.

In January 2016, IRAS released an updated version of its 2015 transfer pricing guidelines. The updated version provides additional guidance on the application of certain transfer pricing methods and amended guidance regarding MAP and APA processes. The fact that IRAS has updated its guidance within a span of one year reflects the importance of transfer pricing as well as the increasing appetite of Singapore taxpayers for resolution of controversy through MAPs and APAs. In fact, as of March 2015 IRAS had 39 APA applications and 17 MAP cases under review.

## Transfer pricing audits

Transfer pricing audits have slowly evolved into two distinct channels in Singapore.

The first channel is the conventional route of tax queries, where recently there has been an increase in emphasis on transfer pricing matters. In particular, there are several questions on transfer pricing in the queries and often there are several rounds of queries focussed on transfer pricing matters. It is the norm for IRAS's queries to be drawn out for the better part of a year.

In addition to the conventional route of tax queries, the Transfer Pricing Consultation process, which is often the precursor to a transfer pricing audit, is also widely used by IRAS. Under this approach, IRAS will usually

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Geoff has been acknowledged several times by the World Tax Guide for transfer pricing excellence in Singapore and was instrumental in the International Tax Review's accolade to KPMG Singapore as the National Firm of the Year for Transfer Pricing in 2016. His viewpoints and articles on transfer pricing issues can be found in industry publications such as CCH, International Tax Review, and accounting industry publications in Canada and Singapore. He has also recently been quoted in various publications for his thoughts on BEPS-related developments. Over the years, Geoff has shared his thoughts at over a hundred conferences and events in Singapore as well as globally.

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Felicia is a Director in the Transfer Pricing Practice at KPMG Singapore and the Financial Services Transfer Pricing lead in Singapore. She has over a decade of experience in providing transfer pricing services to multinational clients in Singapore, the US, and the Asia Pacific region. In 2008, she returned to Singapore after embarking on an international rotation with KPMG LLP's Silicon Valley office.

Felicia's experience includes advising on transfer pricing planning and documentation projects to determine proper arm's-length compensation for tangible property, intangibles, and intercompany services. In addition, she has assisted in the preparation of cost allocation studies for global/regional headquarters, as well as audit defence assistance and conducting transfer pricing risk analyses. She has also been involved in the negotiation and implementation of unilateral and bilateral advanced pricing arrangements (APAs) and mutual agreement procedures (MAPs). Felicia has also led several value chain management projects and advised clients on how to comply with OECD BEPS guidance.

Felicia is a regular speaker on global transfer pricing at client seminars and published a number of articles in connection with transfer pricing issues. She was recognised as a leading adviser in Singapore in the inaugural edition of the *International Tax Review's* "Women in Tax Leaders" guide.


first approach the taxpayer with a list of basic questions on the related-party transactions including a request for the taxpayer's transfer pricing documentation. This is usually followed by a detailed questionnaire of two to four pages, often containing 10 to 12 questions, some of which have several sub-sections. The information gathered during this process is fairly comprehensive and goes beyond the nature of the related-party transactions to often obtain an appreciation of the taxpayer's business. Typically, after collecting and reviewing the information over one or two rounds of correspondence, IRAS will request a meeting with the key representatives of the taxpayer to verify their understanding based on this desktop review and build upon their knowledge of the taxpayer's business. At the end of the Transfer Pricing Consultation process, which can easily take beyond a year, IRAS may propose a transfer pricing adjustment or advise the taxpayer on how best to improve its transfer pricing practices, eg to prepare, improve or submit Singapore-specific transfer pricing documentation.

### SINGAPORE – Information in relation to implementation of CbCR, Master File and/or Local File (BEPS Action 13)

IRAS has in place guidance for documentation based loosely on the Master File and Local File concept as part of the new transfer pricing documentation requirements introduced in 2015, applicable for Year of Assessment 2015. On June 16 2016, the Ministry of Finance announced in a press release that Singapore has become the latest participant to the OECD's inclusive framework for implementation of measures against BEPS and will implement CbCR. Singapore's CbCR requirements will apply to multinationals whose ultimate parent entity is in Singapore, and whose group turnover exceeds SGD 1.125 billion – equivalent to the threshold of €750 million specified by the OECD. Multinationals whose revenues exceed the threshold are required to file their CbC report with IRAS within 12 months from the last day of the financial year. The foregoing will affect multinationals whose financial years begin on or after January 1 2017. Hence, the first wave of Singapore CbC reports will be due by December 31 2018. IRAS will consult Singapore-headquartered multinationals further on the implementation details of CbCR, and release these details later within this year.

# BEPS and transfer pricing in Korea

Gil Won Kang, Seung Mok (William) Baek and Sang Hoon Kim, partners at **KPMG in South Korea**, look at BEPS Action 13, the potential controversies surrounding it, APAs and the simplified APA programme.

In recent years, transfer pricing issues and cases have risen in frequency and in scope, attracting global attention, and the efforts of Korean tax authorities (KNTS) to meet those demands. A series of amendments have been made to strengthen the transfer pricing regulation including the most recent adoption of OECD BEPS Action Plan 13. The Korean transfer pricing landscape is experiencing a momentum increase in efforts to address the various transfer pricing issues which can affect Multinational Corporations (MNCs) during audits, general compliance regulations, Advance Pricing Agreements (APAs), and dispute resolution mechanisms, eg Mutual Agreement Procedure (MAP).

## BEPS Action 13 three-tiered approach to documentation

As of December 2015, Korea has enacted legislation to enforce BEPS Action Plan 13. Specifically, the legislation requires qualified Korean domestic corporations and foreign corporations with a domestic place, that are of business engaged in cross-border related party transactions to submit the Master File and Local File reports.

The filing of the MF and LF is required if:

- The annual amount of cross-border related party transactions exceeds KRW 50 billion ($42. 5 million); and
- The annual sales revenue exceeds KRW 100 billion ($85 million).

There is also an intention to implement CbCR at the beginning of the fiscal year 2017. There has not been a formal announcement, but there is movement within KNTS to make preparations for this implementation through the new division. The threshold has not yet been determined. It may follow the BEPS guideline of an annual consolidated revenue of €750 million.

In addition, Korea's Ministry of Strategy and Finance (MoSF) announced the introduction of Master File and Local File templates that were designed for use by taxpayers. But if MNCs have their own templates for the Master File and Local File, these templates will be accepted if they meet all the Master File and Local File requirements. Once the template is used, submitted, and accepted by the KNTS, it can be renewed annually, with the exception of certain parts such as economic analysis

The Korean regulations require the Master File and/or Local File for fiscal years beginning on or after January 1st 2016. The submission of the Master File and/or Local Files must be done by the time of tax filing, electronically. Submission of the MF may be in English, but within one months' time, a Korean version must also be submitted.

Failure to submit proper documentation or evidence as requested by KNTS can result in penalties. There is a 30 million KRW penalty for failure to submit the Master Filer and/or Local File. In addition documents that KNTS requests must be submitted within 60 days. Otherwise, the taxpayer may be subject to a non-compliance penalty of up to 100 million KRW.

### Potential controversies surrounding BEPS Action 13:

In Korea, the submission of Master File and/or Local File is by the annual tax filing date which is three months from the end of the fiscal year. In other countries, the submission deadline may, or may not be the same as Korea. Generally, the filing date of other countries is much later than Korea. This could cause potential problems as Korean entities coordinate in getting their Master File and/or Local File must be filed by the deadline of the tax filing.

However, according to the official announcement by the MoSF, in certain cases taxpayers may request that the MoSF consider an extension of their submission of the Master File and/or Local File.

These may include cases where the filing dates of foreign affiliates for the Master File and/or Local File are different from the local entity or where it practically takes a prolonged amount of time to prepare the Master File and/or Local File due to the coverage of the global business. The extent and possibility of when the KNTS would allow the extension of these cases is vague and uncertain.

There are also some issues that may arise surrounding the adoption of the CbCR. Although Korea has not yet implemented the CbCR standards, certain countries, such as the UK require CbCR. In this case, even if the Korean entity does not have to prepare the CbCR in Korea, if the entity also operates in the UK, it will need to prepare the CbCR for UK submission.

If Korea joins other countries for the Automatic Exchange of Information (AEOI), with the implementation of CbCR standards, Korea is going to be required to provide CbCR information to other countries. For this reason, the local implementation of CbCR in Korea is going to be carefully considered along with the issue of AEOI.

With respect to AEOI, KNTS may join this year. As of now, a separate division within KNTS has been formed for the purpose of AEOI and CbCR related tasks (Master File and/or Local Files are not going to be subject to AEOI).

### APA

In Korea, APA has become the preferred tool for MNCs to limit their transfer pricing risks, reducing risk for double taxation in their overseas related party transactions.

Due to the increasing number of APA and MAP requests, KNTS has created an additional unit called the MAP division to support the increase in demand. Before the new division, Competent Authorities (CA) faced many challenges in juggling the varying taxation issues, meetings with other CA's, global conferences, in addition to the numerous APA cases. This left many cases unresolved, or extended processing time. After the creation of the MAP division, in addition to the previously existing APA division, KNTS is now able to provide more timely solutions to APA concerns. The new MAP team covers the regions in North America, Europe, and Australia. The APA team will focus mostly on the Asia pacific regions. It is expected that more cases will be accepted and settled moving forward.

But with the new BEPS initiative there is a potential area of controversy with companies filing for APAs. APA companies must submit an annual report. With the implementation of the LF requirement, certain APA companies will be required to prepare both the APA annual report and LF.

While in the LF, these APA companies can briefly describe the APA terms and conditions, it certainly increases the burden of compliance for the APA companies.

### Simplified APA programme

Under the existing APA programme, the in-depth review of KNTS is necessary to examine the transactional and functional profile of transaction parties, and application of the most


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Gil Won was a member of the competent authority team in Korea's National Tax Service and handled various negotiations with G8 nations.

He continues to hold seminars for the Korean government and Korean multinational companies on transfer pricing issues. During 2013, Gil Won was selected as one of the World's Leading Transfer Pricing Advisers by Euromoney's Guide and his transfer pricing team was also ranked as a Tier 1 of the transfer pricing advisory group in Korea by the *International Tax Review* in 2013.


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He is a member of Korea CPA/CTA and takes care of KPMG's key multinational clients. Recently he has held numerous seminars for Korean multinational companies on transfer pricing matters, including BEPS action plans, and providing clients with various TP services based on their trust in his experience.


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Sang-Hoon managed international investigation, analyses on foreign companies, and funds-related projects. Sang-Hoon conducted management of revenue during his time in District Tax Offices of the NTS.

As a tax examiner, he was also involved in various tax audits involving transfer pricing, beneficial interest, permanent establishments, thin capitalisation, and offshore tax evasion issues.

appropriate transfer pricing method. This can cause the APA evaluation process to be prolonged to more than two years. Consequently, this can add to the burdens on the taxpayer with incremental time and cost. Thus, the existing APA programme has become a tool utilised by mostly large MNCs. In response, the simplified APA programme was created to help streamline the process for small- and medium-sized enterprises (SMEs).

The simplified APA programme was launched in January 2015 and has been made available to SMEs in manufacturing, wholesale/retail, and service industries. It will gradually be made available to the remaining industries. Those SMEs with an annual sales of 50 billion KRW or less (approximately $46 million) qualify for the programme. With the simplified APA, it is predicted that proceedings will be concluded within one year.

The results of the simplified APA would be exemption from the KNTS tax audit on the covered transaction for the evaluation period which is the covered period of APA. In addition, the MNC would be able to resolve the issue of uncertain tax risk for the covered period.

### Local audit trends

During audits, challenges from the KNTS can arise with respect to the selection of comparable companies in the Local File: ASPAC vs. local Korean comparable set. For instance, in the luxury goods and automotive industries, it is difficult to find local independent companies engaged in the similar business activities as the tested party. Consequently, it is generally the case that the Korean third parties selected as comparable companies lack comparability. However, the KNTS does not generally want to compromise on the use of an ASPAC comp set instead of a Korean comp set. As such, KNTS will usually give preference to the local comp set over the ASPAC comp set, even in the case where the ASPAC comp set could be considered more comparable.

In order to prepare for this issue, it is best to carefully prepare the LF in accordance with the local regulation and practice. If the LF for the Korea-based company is prepared by the foreign affiliate/parent company, a local review of the LF is highly advised especially because of the recent audit trend in which somewhat aggressive approaches have been taken by local tax auditors. Examples of recent issues include royalty and subsequent withholding tax issues.

# Sri Lanka: Moving toward enforcement

Shamila Jayasekara, a partner at **KPMG in Sri Lanka**, examines the local tax environment, BEPS, APAs and audits.

### Local tax environment

Transfer pricing rules were introduced to Sri Lanka in 2006 and became enforceable from 2008, although they were not administratively enforced.

Through regulations issued in 2015, transfer pricing was administratively enforced, requiring companies to submit an Independent Accountant's certificate & Director's certificate to the revenue authorities, effective from the years 2015/16. The companies are also required to maintain documentation to prove the arm's length nature of the transactions. Presently, there is no database of companies available in Sri Lanka to perform a comparability analysis. Revenue authorities have also not prescribed a suitable database to perform the analysis.

### View of BEPS

Sri Lanka is not a signatory of the OECD. Since Sri Lanka is in its early stage of implementing transfer pricing, so far no steps have been taken by the Revenue authorities to adopt BEPS action plans.

### Local updates in relation to APAs

As per the local law, there is an option to enter into unilateral or bilateral APAs. However, so far, no APAs have been concluded by the Revenue authorities and they have intimated that they do not intend to enter into any APAs for a couple of years.

### Audits and other relevant updates.

According to the regulation, the Revenue authority can initiate a transfer pricing audit within five years from the year of assessment. Since enforcement of transfer pricing is new to Sri Lanka, Revenue authorities have not raised many assessments and are still at the stage of collecting information and understanding the prevailing TP issues. Indications are that the focus will be on international transactions.

### Penalties on non-compliance

Penalty provisions specific to transfer pricing, have not been introduced in the regulation, as yet.


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Shamila has experience in tax engagements across a range of industries including banking, financial services, technology, telecommunication, energy, manufacturing, tourism, consumer markets, retail and infrastructure. She has led engagement teams in conducting tax due diligence assignments on target entities across a number of sectors covering banking, industrial, manufacturing, services and technology. She has also advised on tax implications and structuring pertaining to a number of new inbound investments including Strategic Development Projects to Sri Lanka covering both foreign direct investments and acquisitions.

She has led the tax teams on tax compliance and advisory engagements for a number of financial services entities in the country. Shamila will also be available to provide industry insights as she previously served as the head of tax for a large diversified group which also had a financial and investment cluster. Shamila handles tax advisory and compliance related services covering direct and indirect taxes. Her clients include local conglomerates, multinationals and companies on the stock exchange.

In 2015, Shamila set up and now leads the Transfer Pricing Unit of KPMG. At present, KPMG are market leader in transfer pricing and have won engagements in FMCG, Apparel, IT Service & Industrial sectors. Shamila has also been working very closely with the Department of Inland Revenue and assisted them in implementing transfer pricing in Sri Lanka and has been an active speaker at public forums on the subject.

# Insights into transfer pricing in Taiwan and recent tax developments

Sherry Chang, a partner in **KPMG in Taiwan**, and Karl W Chan, a director, discuss the Panama Papers, BEPS, transfer pricing audits and recent amendments to transfer pricing guidelines.

### The impact of the Panama Papers

The revelations of the Panama Papers are stimulating actions globally to combat tax avoidance. Without exception, they are also prompting the Taiwanese government to take more progressive enforcement action and crack down on tax evasion. Domestically, the existing anti-tax avoidance regulations consisting of transfer pricing rules, thin capitalisation and the principle of sustenance, are already promulgated by the Taiwan tax authorities. As for Controlled Foreign Company (CFC) rules and Place of Effective Management (PEM) – two essential anti-tax avoidance instruments that specifically tackle the use of tax havens to avoid paying taxes – have been suspended for three years.

With the global phenomenon of anti-tax avoidance, it is highly anticipated that Taiwan's legislature will swiftly pass two crucial anti-tax avoidance amendments. However, due to the historical background, many investment structures of Taiwanese companies were designed to invest in China through a company located in an offshore country. Hence, in order to alleviate the impact on Taiwanese companies, the Ministry of Finance (the MOF) proposed that the draft amendments will only be ratified with the condition of the effective of cross-strait tax treaty.

### Updates on BEPS actions

Though Taiwan is not a member of the OECD, the MOF publicly expressed their intention to implement some aspects of the BEPS action plans – with at least minimum standards – in response to any new international trends. Meanwhile, the MOF also addressed the BEPS project on the whole, which could have a significant impact on the way tax treaties are drafted in the future in order to prevent treaty abuse. Apart from undertaken internal evaluations, several public consultative meetings with industry and tax professionals have been held by the MOF to discuss the BEPS Action plans, including BEPS Actions 1, 2, 3 and 13. It is widely expected, with some degree of certainty, that the revelations of the Panama Papers will prompt the MOF to take more action at a quick pace to respond to the BEPS Action plans.

For BEPS Action 1, related to the tax challenges of the digital economy, various issues have led to discussion as the tax system has been unable to collect a fair share of taxes from e-commerce transactions. From a VAT perspective, it is considered that the possibility to remove or stricter VAT exemptions on the import of low value goods in order to shut down tax loopholes.

The proposals for non-resident e-commerce suppliers (B2C transactions) are engaging sales within Taiwan is obliged to the VAT registration as B2C transaction is presently applying for the change reverses charge mechanism in Taiwan.

In relation to income tax, there are suggestions to revisit the feasibility of PE treatment in connection with foreign entities engaging in e-commerce activities in Taiwan. Although these issues are still under discussion, some relevant amendments and regulations are expected be made within next few years.

Taiwan tax authorities adopted the concepts of the BEPS Action 2, that tax planning based on hybrid mismatches should be restricted, even though cross-border hybrid instruments are not commonly used in Taiwan due to regulatory restrictions. However, the MOF welcome any public feedbackand opinions and continually evaluate any feasibility proposals on BEPS Action 2.

Regarding CFC rules in BEPS Action 3, as previously mentioned, in the wake of the revelations of the Panama Papers, the application of CFC rules will be soon implemented into domestic law in order to curb perceived tax avoidance through foreign retention.

In respect of the implementation and application of BEPS Action 13 on transfer pricing documentation and CbCR, Taiwan tax authorities have indicated that it may be possible to amend domestic transfer pricing regulations in order to reflect BEPS Action 13 guidelines. From the Taiwanese tax perspective, it is anticipated that the content of CbCR will align with the OECD format as long as the threshold for preparing CbCR complies with OECD's recommendations. However, the timeframe for implementing CbCR is uncertain in Taiwan. As a result, the preparation of CbCR for Taiwan multinational companies may be subject to earlier deadlines for subsidiaries or branches located in other countries where the timing requirement is in line with the OECD's recommendations. In relation to the Master File requirements, specific information relating to intangibles and financial activities will surely be embedded into the revised TP rules in the future.

## The key focus of transfer pricing audits

Taiwan tax authorities have been intensifying the strength of TP audits for quite a number of years. While Taiwan tax authorities continually focus on the application of transaction-by-transaction approaches and the examination of selecting appropriate profit-level indicators in applying transactional profits methods, the following issues are the main areas for TP adjustment once TP audits come into place. It is advisable for taxpayers to take proactive actions regarding these issues, including reviewing TP policy and preparing TP document, because once TP adjustments are posed it can lead to serious double taxation.

### Technical services fee

For the synergistic benefits of group operations, larger Taiwanese companies dispatch their employees as expatriates to overseas manufacturing affiliates to provide technical support. However, Taiwanese companies provide such technical services to their affiliates without charging compensation, as the cost of expatriates are still recorded into Taiwanese company accounts. From tax authorities' point of view, the Taiwan tax revenue base is seriously deteriorating by that arrangement.

Taiwan tax authorities conducting TP audits obtain data from the immigration bureau to scrutinise how many days of the employees have remained overseas. If the duration of the overseas stay exceeds 183 days in one calendar year, the tax authorities regard these employees as being sent by Taiwanese companies to overseas affiliates to provide services, and therefore technical services fee should be charged.

As a result, this leads to a huge number of TP adjustments in many TP audit cases by calculating salary expenditures of dispatched employees with certain mark-up rate.

Taiwan tax authorities take a strong view that once employees of Taiwanese company stay overseas more than 183 days, they will consider rendering services to overseas affiliates, no matter how strongly the taxpayers argue that the purpose of dispatching their employees is for the synergy of the group as a whole.

### Exploitation of intangibles

The employment of intangible assets is another key focus for tax authorities when conducting a TP audit. Considering group cost-effectiveness, a number of Taiwanese-based companies shift manufacturing functions overseas and keep core-value functions, including R&D and sales activities performed in Taiwan.

Initially, the overseas manufacturing affiliates merely carry out minimal manufacturing functions. For the time being, the affiliates are engaging in sales functions locally for the expanding oversea local market. However, when tax authorities inspect the financial performance of Taiwanese-based companies and their affiliates during a TP audit, it may come to light that the profit of manufacturing affiliates is more lucrative than the Taiwanese headquarters.

Tax authorities argue that the reason the affiliates are more profitable is because the affiliates are involving the use of intangibles in connection with sales of goods. The intangibles are developed by the Taiwanese headquarters through the performance of substantive R&D activities and the expenditure spend on R&D activities also applies for tax incentives in Taiwan. Therefore, Taiwan tax authorities hold a strong position that at least a portion of such excess profits generated by the overseas manufacturing affiliates should be reallocated to Taiwan headquarters by compensating the use of intangibles. Therefore, it is critical to evaluate how value is generated by


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the group and the contribution that the associated affiliates make to that value creation in order to mitigate TP risk.

### Intra-group guarantee arrangements

Regarding intra-group guarantee arrangements, although there is a strong argument about whether or not the guarantor situated in Taiwan should charge guarantee fees from the guarantee for the intra-group guarantee arrangement. However, tax authorities strongly declare that the guarantee generally has received economic benefits from the guarantee arrangement through savings of funding costs; in addition, the guarantor has been exposed to financial risk arising from the default of the guarantee. With key strong aspects, the tax authorities believe that a guarantor must be compensated with arm's length guarantee fees. However, the difficulty is in how to determine the guarantee fees is within arm's length since there is rarely comparable information in these conditions and economically relevant circumstances. Practically, it leaves room for negotiation with tax authorities if there is no comparable information.

## Recent amendments to transfer pricing guidelines:

Additional TP amendments have been introduced by the MOF since the TP assessment rules were promulgated nearly a decade ago. The major amendments include that application of the arm's length principle in business restructuring and simplification of Advance Pricing Agreements (APA) application procedures.

### Business restructuring

With reference to the report on the transfer pricing aspect of business restructurings in Chapter 9 of the OECD TP guidelines, the new requirements for business reorganisation, is that businesses should comply with the arm's length principle in their related-profit distributions that are involved in the business restructure.

In order to justify whether the arm's length principle is met, business should take into account certain factors such as whether business restructuring is in conformity with the economic substance, or identifying the allocation of functions, assets and risks before and after the restructuring, and whether the attributed profit is arm's length. According to the amendments, businesses involved in the business restructuring are required to prepare the function and risk analysis of the current and the preceding years.

### Advance Pricing Agreements

The thresholds for applying for APAs are significantly reduced from total amount of the transactions being no less than NT$1 billion ($31 million) or the annual amount of such transactions being no less than NT$500 million to total amount of the transactions being no less than NT$500 million or the annual amount of such transactions being no less than NT$200 million. Regarding the new mechanism for the application of APA, the period for submitting full documentation and the transfer pricing report would be extended from one month to three months. In addition, there is the option for taxpayers to apply a pre-filing meeting with tax authorities to facilitate the tax authorities' assessment of whether to accept the APA application. It is highly recommend that a multinational enterprise with large amounts or complex related-party transactions considers utilising APAs as means to eliminate tax risks and secure tax certainty.

In addition, Taiwan is expanding its treaty network. It is encouraging taxpayers to apply bilateral APAs to limit transfer pricing risks in the future.

# The game has changed …

Benjamas Kullakattimas and Abhisit Pinmaneekul, partners at **KPMG in Thailand**, discuss the local tax environment including transfer pricing audits.

## Local tax environment in Thailand

The Thai Revenue Department (TRD) has conducted transfer pricing audits based on general tax provisions stating that transactions must be made at the market price. Since May 2002, the TRD has requested transfer pricing documentation from companies in order to conducting transfer pricing audits based on Departmental Instruction No. Paw 113/2545 (Paw113).

The game changed after May 7 2015 when the cabinet of Thailand approved a draft Transfer Pricing Act in order to prevent tax evasion due to transfer pricing applied between related entities and to respond to BEPs Action 13. The main framework of the draft Transfer Pricing Act is to require taxpayers who have related-party transactions to prepare and submit documentation to the Revenue Department. Transfer pricing documentation must be submitted to the Revenue Department within 150 days after the last day of the accounting period. If the entity fails to prepare or submit the completed documentation, the entity will face a penalty of up to 400,000 Thai Baht ($11,000).

Since then, an increasing number of listed companies and multinational companies which have significant related party transactions have started preparing transfer pricing documentation. They do this in order to review and evaluate their application of transfer pricing to determine whether they have acted in accordance with the arm's length principle and then take steps to manage transfer pricing risks in advance.

From recent discussions with the TRD, the draft Transfer Pricing Act is at the level of review by the Council of State. The Council of State has called upon the TRD to explain and support its draft several times. Practitioners and senior tax officers speculate that the Transfer Pricing Act will be enacted in 2016 and the TRD will issue sub-laws providing more details on the following.

### The threshold value of related party transactions:

Similar to other countries, not all companies will be required to prepare transfer pricing documentation. Therefore, it is highly possible that the TRD will determine the threshold value of related party transactions. Based on our discussion with senior tax officers and our analyses of transfer pricing thresholds in the Asia Pacific region, we believe that taxpayers who have conducted related-party transactions a value more than somewhere in the range of 100 to 500 million Thai Baht will be required to prepare transfer pricing documentation.

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Benjamas is the Partner in Charge of KPMG Thailand's Tax function and has over 25 years of experience in taxation. She has a wide range of experiences in taxation and transfer pricing.

Her transfer pricing experience includes the review of transfer pricing and tax issues, assistance in transfer pricing documents and providing comment on Thai tax and transfer pricing implications for the transactions including transfer of tangible and intangible properties , inter-company services and cost-sharing arrangements . She has also assisted in advanced pricing agreements and audit examinations.

Benjamas is a frequent speaker on Thai taxation for the firm and public seminars and the lecturer at universities in Thailand.


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Prior to joining KPMG Thailand, Abhisit worked in transfer pricing area at KPMG Singapore for three years. He also has led and conducted a number of local/global transfer pricing planning and documentation engagements and reviewed various transfer pricing systems, cost structuring, as well as restructuring global business models and supply chains. He also assists clients in customs, tax and transfer pricing audits as well as negotiating with the tax authorities and leads Bilateral Advance Pricing Agreement. He has been a trainer and speaker for Transfer Pricing seminars and the technical sharing session of OCED transfer pricing guidelines and BEPS for the tax authorities. He has been a lecturer of a tax planning course in Chulalongkorn University.

### Disclosure of related party transactions:

At present, the TRD requests that a taxpayer disclose its information on related party transactions through the transfer pricing form for the purpose of transfer pricing audit. The transfer pricing form requires a taxpayer to disclose information on the type of related party transaction (ie purchase of goods, provision of services, or royalty payments), the name and location of the related entities, and the transacted amount, for example.

Thus, should the Transfer Pricing Act be enacted in Thailand, it is likely that the TRD will require the submission of a transfer pricing form together with a company's annual tax return filing. It is highly possible that the TRD will add more questions than those in the used transfer pricing form. New questions may include yes/no question about preparation of contemporaneous transfer pricing documentation for the TRD to be able to determine which taxpayers are liable for the upfront penalty of up to 400,000 Thai Baht.

### Master File and CbCR:

Even though Thailand is not a member of the OECD, the TRD has been holding internal discussions considering whether the TRD should require Master File and CbCR. We believe that the TRD will eventually issue sub-laws that require both. This is because there has been an increasing number of Thai multinational companies who invest in overseas countries which have specific transfer pricing laws and follow BEPs Action 13. If the TRD does not put the law in place, it is likely that Thai multinational companies will still submit Master Files and/or CbC reports in other countries (ie surrogate countries). This may put the TRD at a disadvantage with respect to not having the full information in its hands or not being able to control information.

### Bilateral Advance Pricing Agreement (BAPA)

After the APA Guidance was issued by the TRD in 2010, more and more taxpayers have submitted applications for BAPA to the TRD. Because of this, it has been observed that the TRD has become stricter in the screening process in accepting BAPA applications; especially for aggressive tax planning to try to adjust down its profit in Thailand through BAPA.

### Transfer pricing audit trend in Thailand

In the past, transfer pricing audits have been primarily conducted by a specialised transfer pricing audit team at TRD headquarters. Similar to other countries, the TRD targets loss making companies, and those with fluctuating margins, high service/royalty fees, and significant level of overseas related-party transactions as their first priority. However, we have seen increasing trends in the following:

- The general tax audit teams of TRD have started to conduct transfer pricing audits, as well. The trend has been for a general tax audit team has finished a review of a company's corporate income tax, they continue to investigate transfer pricing issues;

- The tax officers look further into the details of segmented profitability, ie tax-exemption segment vs tax-paid segment, related-party vs unrelated-party segment, domestic vs export segment;
- If a company has had a business restructuring, the taxpayer needs to be more cautious about exit charges that may be challenged by the TRD; and
- The TRD may challenge and cancel losses carried forward if the loss is due to transfer pricing issues.

With all of the above in mind, it is strongly recommended to have transfer pricing documentation with Thai benchmarking studies prepared in order to comply with the upcoming new transfer pricing laws and to manage transfer pricing risks in advance.

# At a turning point for BEPS-related tax reforms

**Thuy Duong Hoang**, a partner at **KPMG Vietnam**, provides an update on transfer pricing management, audits, APAs and offers a view of BEPS.

## Update on local transfer pricing management

The year 2016 marks the milestone of a decade of transfer pricing regulations in effect in Vietnam. Since the release of Circular 117/2005/TT-BTC, subsequently revised and replaced in 2010 with Circular 66/2010/TT-BTC in effect, the Vietnamese tax authorities have gradually increased the level of enforcement through transfer pricing audits.

Led by the General Department of Taxation (GDT), the central tax office, provincial tax authorities have executed the Action Plan released by the Ministry of Finance (MOF) on transfer pricing management for the 2012 to 2015 period. The GDT established a specialised transfer pricing team in February 2012. Official transfer pricing audit divisions were set up at the GDT and some major provincial tax offices (ie Hanoi, Ho Chi Minh City, Dong Nai and Binh Duong) in late 2015.

## Transfer pricing audits – controversy and risk management

Local regulations require that contemporaneous transfer pricing documentation (in Vietnamese) must be created and provided to the tax authorities within 30 working days from the authorities' written request. However, in practice, an even shorter notice is given to taxpayers where documentation is requested before or during a tax audit that is generally mandated under laws to be completed within 30 days.

There is no clear procedure to follow for a transfer pricing audit in Vietnam. A specific transfer pricing audit can be initiated, or it can form part of the scope of a general tax audit. Each year the tax authorities select companies in a few specific industries for tax audits. The industries targeted for transfer pricing audits vary from year to year.

Companies having recurrent tax losses, significant decreases of taxable income year-to-year, significant related party transactions (especially management fees, royalties and interest costs on intercompany loans) may be selected for an audit ahead of others. In recent audits, the scope has been extended beyond the review of tangible product transactions (ie manufacturing and distribution activities) to include those transactions involving intangibles, management fees, and intra-group financing.

In 2015, tax and transfer pricing audits were conducted on 4,751 companies which reported tax losses, had significant related party transactions, and/or was suspected of abusing transfer pricing matters. This represented a 30% year-on-year increase and resulted in a total tax loss reduction of VND 10,050 billion ($450,000), a total deductible expense reduction of VND 303 billion, and collection of VND 1,062 billion in additional tax and penalties.

Key notes from recent transfer pricing audits are:

- Transfer pricing adjustments were made in case tax payers failed to explain tax losses, or in case transactions were not, in the tax authority view, carried out at arm's length in accordance with the Tax Administration Law and transfer pricing regulations. It is notable that, due to the definitions of 'relationship' in the regulations, transfer pricing adjustments were also applied to transactions with business partners that account for the majority of the taxpayer company's business (eg the business partner accounts for 50% of the taxpayer's sales), even though they are independent of each other in terms of ownership or management;
- The median value of an interquartile range for each year under tax audit was widely used for purposes of transfer pricing adjustments without consideration of the taxpayers' economic circumstances such as business start-up or difficult business conditions; and
- A deemed profit margin was usually proposed by local tax authorities based on their secret comparable data. Having a robust benchmarking analysis is essential to negotiate with the tax authorities on the adjustment. Note, the negotiation process is time-consuming and usually exceeds the prescribed timeline for an audit (ie 30 days from the date of decision on the tax audit). In our experiences, negotiating with the local tax authorities to close the audit at field appears to be a better strategy to resolve an audit, as opposed to the alternative of a dispute resolution process (such as appellations, court actions or Mutual Agreement Procedures).

In conclusion, taxpayer companies should have robust benchmarking and documentation prior to a tax audit which will be useful in case of negotiations in the audit at field.

## APAs

Effective in Vietnam since February 2014, the APA regulations and programme are in the early stages of application but progressing well, despite the fiscal authority's determination to promote APA with an aim of creating certainty and transparency in the tax administration, and inbound investment. Unilateral, bilateral and multilateral APAs are available under the local regulations.

Presently, eight APA applications have been filed or are under negotiation. Seven cases relate to companies engaged in manufacturing activities, and one is engaged in distribution activities. No APA has been concluded to date. The GDT expects to conclude the first APA in 2016.

## MAP

MAP is available under the double tax treaties to which Vietnam is a signatory. Under the local regulations, MAP is applied:

- After taxpayers have fulfilled their tax obligations per the tax authorities' assessment decisions; and


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Duong is a Tax Partner and Head of KPMG's Global Transfer Pricing Services (GTPS) in Vietnam. He has close to 16 years' experience in tax and transfer pricing planning, servicing publicly held and private multi-national and Vietnamese corporations.

**Professional and Industry Experience**

- Duong is leading KPMG Vietnam's GTPS and Value Chain Management advisory groups. Duong has been in charge of hundreds of transfer pricing advisory projects.
- During his international assignment to KPMG Australia, Duong gained experience in global transfer pricing and international tax planning, and transfer pricing documentation.
- Duong has advised a large number of multinationals on tax, customs and transfer pricing planning and compliance, supply chain tax planning, business restructuring, as well as provided tax due diligence and structuring advice on a number of corporate transactions in various sectors including Diversified Industrials, Automotive, Consumers, Financial Services, Infrastructure, Information Technology, Japanese and Korean Markets, and a number of other sectors.
- Duong was the Engagement Partner on a project providing capacity building assistance on transfer pricing (funded by the European Commission) and APAs to the Vietnamese General Department of Taxation (GDT).
- Duong is in regular consultation with the GDT in relation to BEPS.

**Function and specialisation**

- Global Transfer Pricing
- Value Chain Management
- International Tax & Corporate Tax

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- Bachelor of Science (Economics)
- INSEAD-KPMG Executive Development
- Member of CPA Australia

- The cases are not escalated to the court.

The expected time frame for a MAP application is three years from the date of the decision on the transfer pricing adjustments by the local tax authorities.

Presently, six MAP requests are pending in Vietnam, of which five requests are from South Korea and one from Japan. No case has been resolved to date, and no clear timeline within which resolution can be expected.

### View of BEPS

It is noted from the very recent Government's Resolution No. 19 (dated April 28 2016) that a governmental decree on transfer pricing and tax evasions will be proposed by the MOF during 2016. The resolution is made in the broader context with an aim of improving the Vietnamese business environment. The decree is intended to introduce some important changes in tax policy in relation to transfer pricing and preventing tax base erosion.

Based on discussions between KPMG and the fiscal authority, some of the BEPS actions might be taken into account in the upcoming tax regulatory changes, especially in relation to working out tax regulations on the digital economy, tax treaty abuse, limiting the erosion of tax base via interest deduction, permanent establishment, transfer pricing, documentation and reporting.

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