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Asia Transfer Pricing

9th edition



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Unless otherwise stated, all information in this report is based on the tax regulations for the countries reviewed as updated on or after June 15 2017 or from KPMG member firm professionals' experience working with tax clients and tax authorities in their local countries.

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On the cusp of a brave new world

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

Not surprisingly, this year's Asia Pacific (ASPAC) transfer pricing supplement has a strong country-by-country reporting (CbCR) flavour. There are two key reasons for this. First, with more ASPAC countries having adopted CbCR over the past year, there are now only three countries out of the 15 ASPAC countries included in this survey that have not adopted (or indicated an intention to adopt) CbCR: Philippines, Sri Lanka and Thailand. Second, the filing deadline for the first CbC report is drawing ever closer with the first reports due to be filed by May 31 2017 in China, by November 30 2017 in India and by December 31 2017 in a number of countries (Australia, Indonesia and Korea) as shown in the table below.

Further and notwithstanding the guidance provided by the Organisation for Economic Cooperation and Development (OECD), and by individual countries, to facilitate the swift and uniform implementation of CbCR, implementation issues of an interpretative and practical nature continue to arise. In light of this, I asked four KPMG firms located in ASPAC countries that have adopted CbCR (Australia, China, Japan and Korea), to discuss a range of issues encountered by multinational enterprises (MNE) as they prepare their first CbC reports and how these issues are being addressed. Their insights are contained in the following article '*Implementation issues associated with CbCR*'.

The introduction of CbCR is, however, only the first of a number of common themes running through the country updates included in this year's survey. For MNEs, two other common themes could have equally significant if not more significant implications. First, a number of ASPAC countries have recently been, or are in the process of, updating their transfer pricing rules and associated administrative guidance to align them more closely with the OECD/G20's Base Erosion and Profit Shifting (BEPS) project outcomes. Second, there is also evidence that tax administrations in a number of ASPAC countries have been significantly ramping up their transfer pricing compliance activities, underpinned in a number of countries by an increase in staff.

In addition, and although not a common theme at this point in time, it is nevertheless the case that at least one ASPAC country is considering following the path of countries like the United Kingdom and Australia and taking unilateral action that is not consistent with the OECD/G20 BEPS project. In this respect, the New Zealand government released a series of consultation papers in March 2017 that propose, amongst other things, the adoption of a permanent

INTRODUCTION

establishment avoidance rule with elements broadly based on the diverted profits tax in the United Kingdom and Australia's multinational anti-avoidance law, and to place an interest rate cap on deductible interest expense by limiting the interest rate on related party debt to that based on the credit rating of the ultimate parent (plus a margin). Will other ASPAC countries consider going down similar paths? Only time will tell. However, MNEs should not

overlook the prospect that unilateral action by countries in the area of transfer pricing could lead to double taxation that is not able to be relieved under tax treaties.

Clearly, we're on the cusp of a brave new transfer pricing world.

I am confident you will find the information provided by KPMG member firms in this year's ASPAC TP supplement both insightful and timely.

ASPAC countries included in survey	Has adopted (or is in the process of adopting) CbCR	Filing due date of 1st CbC report
Australia	✓	December 31 2017
China	✓	May 31 2017
Hong Kong	✓	2019
India	✓	November 30 2017
Indonesia	✓	December 31 2017
Japan	✓	March 31 2018
Korea	✓	December 31 2017
Malaysia	✓	December 31 2018
New Zealand	Considers current law sufficient to implement CbCR	No specific date in any sources
Philippines	No announcement as at end of May 2017	n/a
Singapore	✓	December 31 2018
Sri Lanka	No announcement as at end of May 2017	n/a
Taiwan	✓	Not yet announced
Thailand	No announcement as at end of May 2017	n/a
Vietnam	✓	September 30 2017

* Note: The dates indicated in the above table reflect the earliest possible filing date for the first CbC report that applies in each country. The actual filing date of the first CbC report for a particular taxpayer may be later than the date indicated for a particular country due to a different accounting or reporting period applying to the taxpayer.

* Above information is based on the tax regulations for the countries included as updated on or after May 1 2017.



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Implementation issues associated with CbCR

By Aaron Yeo of KPMG Australia, Chi Cheng and Rafael Triginelli Miraglia of KPMG China, Yosuke Suzaki of KPMG Japan and Baek Seung Mok of KPMG Korea.

With deadlines for filing the first country-by-country (CbC) reports fast approaching, many MNE groups are busy doing their best to obtain necessary information, to make sense of that information and to get their CbC reports into a format ready for filing.

At the same time, the Organisation for Economic Cooperation and Development (OECD) and tax administrations continue to provide additional guidance. For example, the OECD has most recently issued *'Guidance on the Implementation of Country-by-Country Reporting' BEPS Action 13, Updated April 2017*. While the existing guidance is helpful it is nevertheless incomplete and issues continue to arise as MNE groups proceed with preparing their first CbC report.

This article draws on the experiences of KPMG firms in four ASPAC countries that have adopted CbCR, Australia, China, Japan and Korea, to discuss a range of issues encountered by MNE groups in preparing their first CbC report and how these issues are being addressed.

The issues identified in this article may not be common to all ASPAC countries covered in this survey and local rules or tax authority administrative guidance may determine the approach to be taken in a particular country. Nevertheless it is apparent that MNE groups, regardless of which jurisdiction they call home, are facing many similar implementation issues. This article endeavours to shed light on some of the implementation issues being encountered.

Implementation issues in preparing the first CbC reports

Implementation issues continue to arise that are not addressed by OECD and/or tax administration guidance. A number of these issues are discussed below.

Who is the Ultimate Parent Entity (UPE)?

In many cases, identification of the UPE is likely to be straightforward. However, experience has shown that this is not always the case as the following examples illustrate.

Example 1: Consider the situation of an MNE group with a constituent entity that is listed on a stock exchange in an ASPAC country that has adopted CbCR. At first glance, it might be considered that the listed entity would be the UPE. However, the identification of the UPE is not as straight-forward when a significant interest (e.g. more than 50%) in

the listed entity is held by a group of related private companies incorporated in another jurisdiction that has adopted CbCR.

Example 2: Incorporated joint venture (JV) arrangements between two different MNE groups, where each group owns 50% of the shares in the JV, also raises the question of which MNE group the JV belongs to (and therefore who its UPE is). In this case, the JV is a subsidiary of both MNE groups under the relevant accounting rules applicable to each group and the JV's financials are reflected in the consolidated financial accounts of each MNE group. Does the JV have two UPEs, being the UPE of each of the two MNE groups, and therefore is the JV a constituent entity for each MNE group whose financial data is included in the CbC report for each MNE group?

Reporting financial information in Table 1 of the CbC report

Issues continue to arise for MNE groups in working out what financial information should be reported in Table 1 of the CbC report (Table 1), which stem from interpretational matters, data availability and tax risk management.

Consolidated financial statements or separate entity financial accounts?

An issue being confronted by most MNE groups is whether financial information at the jurisdictional level should be presented in Table 1 based on information prepared for purposes of consolidated financial statements or information sourced from separate entity statutory financial accounts. Experience has shown there is not a single answer to this question and in many cases the approach adopted will be influenced by the existence or absence of internal systems to collect reliable financial information in a particular and consistent way.

It is not uncommon to encounter situations where audited financial data at the subsidiary level differs materially from the consolidated data available to the UPE (e.g. due to different accounting standards applying or different year ends). In some cases this has generated discussions between different (regional) departments within the MNE group as it is commonly perceived that the likelihood of a local audit is greater when the financial data differs from that available to the respective tax authorities.

Reporting revenue – gross or net?

In the financial services industry it has been observed that situations could arise where related-party transaction revenue might be negative if reported on a net basis (e.g. where interest revenue is reported on a net basis). As the OECD guidance on reporting of revenues does not specify whether gross revenues or net revenues should be used, some MNE groups have considered whether to use gross revenues. However, reporting revenues on a gross basis would lead to



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considerably larger revenues being reported in the CbC report than would be reported in the MNE group's consolidated P&L. Care is needed.

Table 3 (Additional information) of the CbC report

Where issues similar to those discussed above are under consideration by an MNE group, the MNE group should also consider the potential additional disclosures that may need to be made in Table 3 (Additional Information) of the CbC report (Table 3) and the potential implications of such disclosures. The key disclosures required in Table 3 with respect to the financial information disclosed in Table 1 relate to the sources of data used.

While the financial information disclosed in Table 1 can use data from the MNE group's consolidation reporting packages, separate entity statutory financial statements, regulatory financial statements, or internal management accounts, the OECD seems to clearly intend that CbC reports should



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consistently use the same sources of data from year to year. As such, Table 3 requires the sources of data to be briefly described and that where a change is made in the source of data used from year to year, that Table 3 should explain the reasons for the change and its consequences.

Managing potential tax risks

Managing potential tax risks is a key part of any MNE group's business. The two examples below show some potential tax risks being identified by ASPAC-based MNE groups due to the way financial information might be presented in the CbC report.

Example 3: In industries such as oil & gas, it is very common for MNE groups to enter into production-sharing contracts whereby several parties set up a joint operation entity. Similarly, in the infrastructure sector, it is common for contractors to form a consortium and set up a joint-enterprise to execute a project. Under accounting standards applying to joint arrangements, revenue from joint operations could be recognised in the accounting statements either in the revenue line (which would be disclosed in Table I as revenues)

or as an investment using the equity method (which may not be disclosed in Table 1 revenues). As such, following the accounting standards could lead to revenues being perceived to be over/under stated in particular jurisdictions and therefore present a potential tax risk.

Example 4: Some MNE groups historically may not have introduced transfer pricing policies for their cross-border related party transactions with the outcome being a lack of financial performance consistency with respect to foreign subsidiaries performing similar functions. Consequently, a number of MNE groups have recently been establishing or improving existing global transfer pricing policies, focusing on consistency. While such developments should provide better overall transfer pricing outcomes going forward, potential tax risks could arise given the lack of consistency in years prior to the introduction of CbC reporting.

Mismatches between filing deadlines for tax and accounting information

A common issue faced by MNE groups is managing mismatches between filing deadlines for tax information



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(including the CbC report) and accounting information across multiple jurisdictions. Under CbCR introduced in most jurisdictions, MNE groups are generally required to prepare and to file a CbC report in electronic format within one year of the end of the relevant fiscal year of the UPE.

To address timing mismatches, some ASPAC countries have introduced legislative or administrative mechanisms that enable an extension of time to be granted for purposes of lodging the CbC report (Korea) or that would permit the MNE group to align the 12 month reporting period for the CbC report in the local jurisdiction with the reporting period of the UPE (Australia).

Particular issues relating to timing mismatches have arisen in China and Japan which have been addressed as described below.

Japan

The fiscal year of most Japanese companies begins on April 1. The first year of CbC reporting in Japan relates to the fiscal period ending March 31 2017, with a filing date of March 31 2018. By contrast, the fiscal year of many subsidiaries of Japanese companies incorporated in other

countries begins on January 1. As such, the filing date of the CbC report in these other countries is likely to be earlier than the filing date for the CbC report by the reporting entity in Japan. Generally, the subsidiaries of Japanese companies incorporated in other countries would apply for a filing extension until the reporting entity files its CbC report in Japan. However, the tax authorities in some countries may not grant such filing extensions. To address this concern, the Japanese tax authority has indicated that it will allow the Japanese reporting entity to file the CbC report before the due date for filing in the first year of CbC reporting.

China

In China, Announcement 42 requires the CbC report to be filed concurrently with the filing of the 'PRC Annual Related Party Transactions Reporting Forms' which are due by May 31 each year. The short timeframe proved to be a concern to some MNE groups, particularly when the country in which the UPE was located had a later filing deadline. This issue was addressed by the Chinese tax authorities by granting an extension to the local filing deadline where the Chinese resident entity provides written evidence that a CbC report for the relevant fiscal period will be filed by the MNE group's UPE or SPE in another jurisdiction which has a later filing deadline. (Available at www.oecd.org/tax/beps/country-by-country-reporting-update-on-exchange-relationships-and-implementation.htm; accessed on May 15 2017.)

Managing a CbC report project

While experiences to date with CbCR vary from country to country and from MNE group to MNE group, there is nevertheless much that is common in relation to managing a CbCR project and much that can be learned from the experiences of other MNE groups.

While the tax functional area is likely to have overall responsibility for the preparation of the CbC report, it is nevertheless crucial to ensure that the accounting, IT and human resources areas are also actively involved. A coordinated and systematic approach to CbC report preparation is preferable and should ideally be part of an MNE group's best practices and align with the internal governance processes of the MNE group.

Based on the experience of KPMG professionals, it seems the most important matter to address for purposes of ensuring a successful CbCR project outcome is to have the right internal stakeholders involved in managing and overseeing the CbCR project from the outset. Often times, this will involve establishment of a steering committee and a day-to-day working group.

Diagram 1 provides a high-level overview of matters to consider in undertaking a CbCR project.

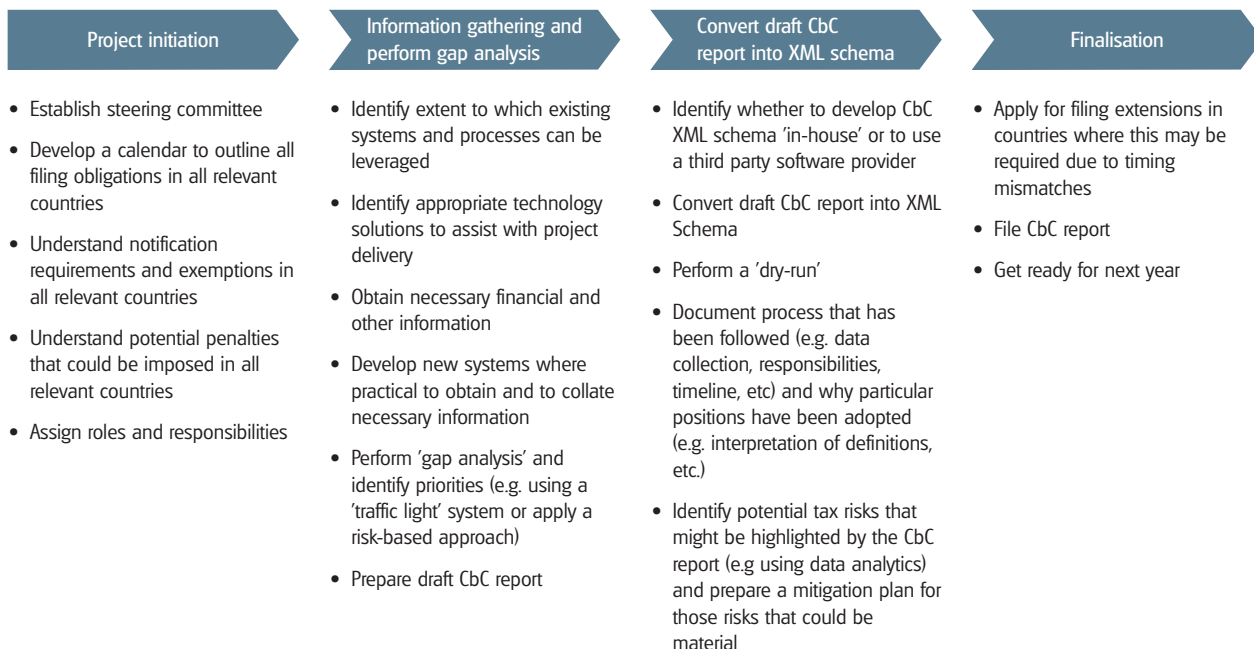
To support ASPAC-based MNE groups to manage their CbCR projects, KPMG professionals have provided a range of assistance, including:

- Providing technical input on the pros and cons of adopting alternative approaches for reporting financial information.
- Identifying potential red-flags based on the audit consolidation working papers.
- Synchronising the audit report preparation process with CbCR – i.e., the internal question list used for audit purposes was linked and cross-referenced in the CbC report, allowing a swift compilation of the CbC report.

- Strategic review of information to be disclosed in the CbC report and setting-up a red-flag indicator tool based on risk indicators such as: tax rate not consistent with statutory headline tax rate, cash tax much lower than accrued tax, etc.
- Having discussions with tax administrations about technical and practical aspects of CbC reporting.

This article has only scratched the surface of potential implementation issues associated with CbCR. For MNE groups faced with the prospect of having to prepare and file their first CbC report, the key recommendation is don't leave things to the last minute.

Diagram 1



After the flood, more rain!

By Frank Putrino and
Damian Preshaw of
KPMG Australia.

The past year has seen a continuation of new legislation, a ramping up of ATO compliance activity and a significant ATO win in the courts in relation to transfer pricing.

For example, in April 2017, we saw the somewhat unusual event of the treasurer and assistant treasurer issuing a joint media release highlighting the ATO's transfer pricing compliance activities:

- 71 audits currently underway in the large business area covering 59 multinational enterprises (MNEs); and
- At least seven major multinational audits expected to come to a head before June 30 (four in e-commerce and three in energy & resources) with expected liabilities to total in excess of A\$2 billion (\$1.5 billion).

Then in late May, the ATO indicated that it expected to issue A\$4 billion of tax liabilities in 2017 against MNEs of which about A\$3 billion is directly related to transfer pricing matters with e-commerce cases accounting for about A\$1 billion, related party financing accounting for about A\$1.5 billion and marketing hubs accounting for about A\$500 million.

Also in April, the Full Federal Court delivered the Commissioner of Taxation a significant win by upholding the Federal Court's October 2015 decision against Chevron Australia in one of Australia's largest tax cases.

And while the above has been happening, the past 12 months have also seen further significant legislative developments relevant to transfer pricing, particularly if you are a Significant Global Entity (SGE) (broadly where the global group has annual global income of A\$1 billion or more) with the:

- Introduction of the diverted profits tax – to apply from July 1 2017;
- Adoption of 2015 OECD BEPS Actions 8-10 – to apply to years of income commencing on or after July 1 2016; and
- A significant increase in penalties for SGEs – to apply from July 1 2017.

This country update discusses the above matters in more detail.

Key legislative developments

Introduction of the diverted profits tax (DPT)

The most significant legislative development relevant to transfer pricing over the past year has been the introduction of the DPT. In February 2017, the prime minister of Australia described the DPT as “one of the most advanced and some would say draconian measures of its kind, in the world” for the purpose of stamping out corporate tax

avoidance. Australia's DPT is similar to the second limb of the UK's DPT.

In summary, the DPT is intended to provide the ATO with additional powers, within Australia's general anti-avoidance regime framework, to deal with global groups who have 'diverted' profits from Australia to offshore associates, using arrangements that have a 'principal purpose' of avoiding Australian income or withholding tax. The DPT will apply to SGEs carrying on business in Australia.

Where the DPT applies, tax is imposed on the amount of the diverted profit at a rate of 40% (Australia's corporate income tax rate is 30%). Any DPT imposed is payable within 21 days of the DPT assessment. The taxpayer has a 12 month review period in which to provide the commissioner with further information disclosing reasons why the DPT assessment should be reduced (in part or in full). If, at the end of that period of review, the relevant taxpayer is still dissatisfied, the taxpayer will have 60 days to challenge the assessment by filing an appeal with the Federal Court. However, and significantly, the taxpayer will generally be restricted to adducing evidence that was provided to the commissioner before the end of the period of review in any Federal Court proceedings.

Managed investment trusts, collective investment vehicles, sovereign wealth funds, complying superannuation funds and foreign pension funds are generally exempted from the application of the DPT.

Limited exceptions

Importantly, the DPT will not apply where it is reasonable to conclude that one of the following exceptions apply:

- **Exception 1: The A\$25 million turnover test** – where the turnover of the taxpayer and other Australian entities in the same global group does not exceed A\$25 million for the year (provided no income is artificially booked offshore).
- **Exception 2: Sufficient foreign tax test** – where the increase in the foreign tax liability is equal to or exceeds 80% of the corresponding reduction in Australian tax.
- **Exception 3: Sufficient economic substance test** – where the profit made as a result of the scheme by each entity connected with the scheme reasonably reflects the economic substance of the entity's activities in connection with the scheme.

In practice, exception 3 will likely be a key area of focus for MNEs and will require applying an Australian transfer pricing lens to the functions, assets and risks of the activities carried out in Australia, as well as to each entity outside of Australia that is connected with the scheme, to demonstrate that the profit made by each entity as a result of the scheme reasonably reflects the economic substance of the entity's activities in connection with the scheme.

Taxpayers most at risk

Taxpayers likely to be most at risk of the ATO seeking to apply the DPT include taxpayers currently involved in a transfer pricing dispute with the ATO where large cross-border loans or a marketing hub is involved, taxpayers who have undertaken business restructures, taxpayers with arrangements covered by taxpayer alerts (e.g. cross-border leasing) and taxpayers who have migrated intellectual property from Australia.

Adoption of 2015 OECD BEPS Actions 8-10 report

Under Australia's transfer pricing rules, arm's length conditions (relevant to cross-border dealings between separate legal entities) and arm's length profits (relevant to cross-border dealings within a single legal entity) are required to be identified so as best to achieve consistency with certain guidance material. Until the recent amendment, the relevant guidance material included the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, as approved by the Council of the OECD and last amended on July 22 2010 (2010 OECD Guidelines). The effect of the amendment is that the 2015 OECD BEPS Actions 8-10 report will also be relevant guidance material for purposes of Australia's transfer pricing rules for years of income commencing on or after July 1 2016.

Increased administrative penalties for SGEs

Notwithstanding the doubling of penalties associated with transfer pricing adjustments for

SGEs in the absence of a 'reasonably arguable position' (RAP) in late 2015, administrative penalties for SGEs have now been significantly increased in relation to 'failure to lodge on time' penalties and penalties relating to statements and failing to give documents to the ATO, with effect from July 1 2017.

'Failure to lodge on time' (FTL) penalties

From July 1 2017, FTL administrative penalties for SGEs will be as high as A\$525,000 for covered documents lodged 16 weeks or later. FTL penalties can apply where there is a failure to lodge an income tax return, notice, statement or other approved form with the ATO by the due date. For SGE's, FTL penalties will also apply to CbC reports and general purpose financial statements not lodged in the approved form by the due date.

Penalties relating to statements and failing to give documents to the ATO

In addition to the increase in FTL penalties, the base penalty amounts for SGEs in respect of penalties relating to making false or misleading statements or failing to give documents to the ATO ('culpable behaviour' penalties)

have been doubled. ‘Culpable behaviour’ penalties are of general application and not specific to transfer pricing cases.

By way of example, the following base penalty amounts will apply to SGEs from July 1 2017 where a false or misleading statement results in a shortfall amount:

Intentional disregard:	150% of the shortfall amount (previously 75%)
Recklessness:	100% of the shortfall amount (previously 50%)
No reasonable care:	50% of the shortfall amount (previously 25%)
No RAP:	50% of the shortfall amount (previously 25%)

CbCR, Master File and Local File

As SGEs turn their corporate mind to the practicalities of preparing the CbC report, Australian local file (ALF) and master file, the ATO has continued to assist by providing guidance on its website. In particular, the ATO issued the combined XML schema for the local file and master file and also the detailed design for the local file and master file (which built upon the local file – high level design document issued in June 2016) in April 2017.

Common questions asked by taxpayers as they navigate through the new processes are shown in Table 1.

ATO has another win in its ongoing legal battle with Chevron

On 21 April 2017, the Full Federal Court delivered the commissioner of taxation another significant win in its ongoing battle with Chevron Australia in relation to the transfer prices it used on certain cross-border related party loans with all three judges finding for the commissioner. The decision in *Chevron Australia Holdings Pty Ltd (CAHPL) v Commissioner of Taxation* [2017] FCAFC 62 addresses the question of whether the interest paid by Chevron Australia on a loan from its US subsidiary exceeded an arm’s length price.

While the Full Federal Court’s decision covered a wide range of matters and addressed Australia’s now superseded transfer pricing rules in Division 13 and Subdivision 815-A, the following key themes are worth noting:

- The independence hypothesis (underpinning the statutory expression of the arm’s length principle) is not to be undertaken as if the Australian borrower was an “orphan” (separate from, and independent of, its multinational parent);
- The fundamental purpose of the reasonable expectation hypothesis is to understand what the taxpayer, or a person in the position of the taxpayer and in its commercial



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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 he helps form to address complex business challenges.

context would have given by way of consideration in an arm’s length transaction; and

- If the evidence reveals (as it did here) that the borrower is part of a group that has a policy to borrow externally at the lowest cost and that it has a policy that the parent will generally provide a third party guarantee for a subsidiary that is borrowing externally, there is no reason to ignore those essential facts in order to assess the hypothetical consideration to be given.

The importance of having comprehensive, relevant commercial and economic evidence to support transfer prices of related party transactions was emphasised by the Federal

Table 1

Question	Answer
When are the CbC report, master file and ALF due?	CbC reports are due 12 months after the end of the CbCR period. For December 31 year ends, the first filings are due by December 31 2017.
How do I file the various reports?	The master file and ALF must be lodged directly with the ATO in the approved XML schema format. The primary obligation to lodge the CbC report is on the Australian taxpayer, but can be satisfied by the parent entity lodging the report with its home jurisdiction and then sharing with the ATO.
Do I have to notify the ATO who is lodging the CbC report?	Yes, the notification will be made in the ALF when that is lodged i.e. there is no obligation in Australia to notify in advance.
Are exemptions from the CbC regime available and in what circumstances?	Yes, an exemption may be available in limited circumstances and must be applied for. The two main grounds are: <ul style="list-style-type: none"> • For Australian subsidiaries/branches, if the home jurisdiction has not yet implemented CbCR, a transitional one-year exemption from the CbC report and master file may be available; and • For Australian headquartered groups, that the group does not have foreign operations.
Does the ALF replace the transfer pricing documentation rules in Australia?	No, the ALF is separate and in addition to the existing transfer pricing documentation rules. The ALF is also very different to the OECD Local File.
Has the ATO provided any administrative concessions to minimise the compliance burden?	Yes, taxpayers will not have to prepare section A of the IDS if they lodge part A of the ALF at the same time as they lodge their income tax return.

Court at first instance, and again highlighted in the Full Federal Court's decision.

Chevron has recently lodged a special leave application to the High Court.

ATO compliance activities

The ATO was given substantial additional funding last year to establish and resource a new tax avoidance taskforce. This taskforce has now been established and resourced with over 1,000 staff, with many coming from the private sector and having transfer pricing experience.

As indicated in the introduction, the ATO is active in its transfer pricing-related compliance activities and continues to focus on marketing and procurement hubs, loans including foreign currency loans coupled with cross-currency interest rate swaps, intangible transfers, loss-making

companies and the potential application of the Multinational Anti-avoidance Law (MAAL). More recently KPMG professionals have seen an increased focus on the Australian pharmaceutical industry and also the automotive sector in light of the impending closure of the remaining automotive manufacturers operating in Australia.

Complementing its transfer pricing-related compliance activities, the ATO has recently issued a number of practical compliance guidelines (PCGs) that convey the ATO's assessment of relative levels of tax compliance risk across a spectrum of behaviours and arrangements:

- PCG 2017/1 – Sets out the ATO's compliance approach to offshore related party procurement, marketing, sales and distribution hubs. The PCG assigns hub arrangements one of six different transfer pricing (TP)

risk categories or zones. Hubs outside the green zone are more likely to be reviewed by the ATO.

- PCG 2017/2 – Updates previously released guidance on Simplified Transfer Pricing Record Keeping (STPRK) options that reduce the compliance burden for certain taxpayers and/or international related party dealings (IRPDs). To the extent taxpayers can apply the STPRK options, the ATO will not dedicate compliance resources to qualifying taxpayers/IRPDs.
- PCG 2017/D4 (*Draft only*) – Sets out the ATO’s proposed compliance approach with respect to cross-border related party financing arrangements. The draft PCG continues the ATO’s colour spectrum approach to assessing tax risk (adopted in PCG 2017/1) to funding arrangements and allocates scores to various attributes of the funding arrangements. It is noted that the scores allocated to the green low-risk rating are largely features only ascribed to AAA-rated loans as opposed to ratios reflecting a broader range of investment grade funding.

Conclusion

The Australian transfer pricing landscape has become a more difficult one for MNEs to safely navigate, particularly where the Australian entity qualifies as an SGE. There are some unique or exceptional features such as the MAAL, DPT and the ALF which deviate in material ways from the OECD/G20’s BEPS project and therefore make Australia an outlier. Proceed with caution!



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2016-2017 Transfer Pricing Developments Review

By Cheng Chi and
Rafael Triginelli
Miraglia of KPMG
China.

The past year witnessed ground-breaking changes in the Chinese transfer pricing landscape. In the wake of BEPS, China moved rapidly to overhaul its TP and anti-avoidance legislation. The new Chinese legislative framework incorporates aspects that can be directly traced to the OECD's BEPS project, while at the same time emphasising Chinese-flavoured issues that have historically been in the State Administration of Taxation (SAT) agenda, such as location specific advantages (LSA), relative contribution of Chinese operations to global value chains, comparability shortcomings etc.

With the release of the 2017 version of the United Nations Practical Manual on Transfer Pricing for Developing Countries ("UN Manual"), China has contributed a new country practice chapter, suggesting policy trends that are expected to steer transfer pricing administration and enforcement in areas such as audit-targeting and controversy, transfer pricing risk management and taxpayer monitoring, competent authority procedures and tax administration infrastructure and resources.

Throughout the past year, China has vigorously stepped up transfer pricing enforcement: audit activity soared and is expected to grow significantly in the near future, especially when taxpayers are unwilling to perform self-initiated adjustments. Moreover, it has been reported by SAT officials that in 2016 the materiality of transfer pricing adjustments increased, on average, threefold in comparison with average amounts in 2011 – i.e., from an average of app. RMB 12 million (\$2.8 million) per assessment in 2011 to app. RMB 37 million in 2016.

Changes to (or introduction of) local transfer pricing legislation (including regulations)

TP legislation overhaul

Until 2016, the main legislative source for transfer pricing matters in China had been the Implementation Measures of Special Tax Adjustments (Guoshuifa n° 2), issued in January 2009 (Circular 2). Circular 2 had in practice served as a consolidation of special tax adjustment rules covering the breadth of transfer pricing, including related party filing, contemporaneous documentation, primary adjustments, audit activity, transfer pricing methods, advance pricing and cost sharing agreements, Controlled Foreign Corporation (CFC) regime, thin capitalisation, general anti-avoidance and corresponding adjustments and Competent Authority matters. In the past year, the SAT has moved to issue separate, topical guidance on substantive issues that superseded



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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. A frequent speaker on transfer pricing and other matters, his analyses are regularly featured in tax and transfer pricing publications around the world. Cheng has been recommended as a leading transfer pricing advisor in China by the Legal Media Group.

Cheng started his transfer pricing career in Europe with another leading accounting organisation covering many of Europe's major jurisdictions while based in Amsterdam until returning to China in 2004.

relevant sections of Circular 2 instead of releasing consolidated legislation.

Transfer pricing documentation

The first part of that initiative resulted in the Announcement on the Enhancement of the Reporting of Related Party Transactions and Administration of Contemporaneous Documentation, released in July 2016 (Announcement 42), discussed below.

Advance pricing arrangements

In October 2016, the SAT released the Announcement on the Enhancement of Administration of Advance Pricing Arrangement (Announcement 64). Announcement 64 formalises some longstanding practices in APA administration and introduces key BEPS Action 5 recommendations, as discussed below.

Anti-avoidance and MAP

In March 2017, Announcement on Special Tax Investigations, Adjustments and Mutual Agreement Procedures (Announcement 6) was issued to regulate the tax audit process, special tax adjustments and to provide guidance on many of the substantive issues related to transfer pricing. Announcement 6 concludes China's TP legislation overhaul. It consolidates previous SAT guidance on self-adjustments and outbound payments from China, and writes into formal guidance some of the existing administrative practices adopted in Chinese transfer pricing audits. Announcement 6 includes provisions on intangibles, intra-group services (discussed in greater detail below), as well as TP methods and comparability, TP adjustments, outbound payments to low-substance entities, MAP and penalties applicable to TP adjustments – People's Bank of China benchmark interest rates plus 5% punitive interest, which can be relieved if the compliance obligation has been fulfilled.

BEPS-related developments (other than CbC reporting – which is addressed below)

In the context of BEPS Action 8-10, Announcement 6 introduced new guidance regarding intangible assets and intra-group inbound services.

Intangible assets

The new guidance on intangible assets adopts the OECD's distinction between legal and economic ownership of intangible assets and emphasises that benefits derived from intangible assets are to be allocated based on economic substance. Drawing on the so-called DEMPE functions which are relevant for the attribution of economic ownership and entitlement to intangible related returns, Announcement 6 puts forward the concept of DEMPEP – the additional "P" standing for "promotion", which indicates SAT focus on the importance of local marketing activities in the value creation process. Moreover, royalty rates should be adjusted when the value of the IP or when functions, assets and risks have changed over time or when DEMPEP functions are not properly reflected in the remuneration.

Intra-group services

In the area of high-risk transactions, outbound payments for non-beneficial or low-substance activities are expected to be subject to more rigorous scrutiny and may be disallowed under certain circumstances. Those include shareholder activities, duplicative services, incidental benefits and, broadly, irrelevant or non-beneficial services. Announcement 6 also leaves out the safe-harbor provision for low value-adding services advocated by the OECD.

Developments in relation to country-by-country reporting (including local file and master file)

Announcement 42 sets forth the three-tiered transfer pricing documentation standard (i.e., master file, local file and country-by-country reporting) devised in the context of BEPS Action 13 and goes beyond the OECD standards by introducing Chinese-flavoured requirements, such as LSA analysis, but also complex requisites such as value chain analysis, with substantial level of entity-specific information requirements throughout the global supply chain. In addition to the three-tiered documentation standard, Announcement 42 reintroduces the special issues files that must be prepared when the taxpayer has entered into costs sharing agreements or the thin capitalisation special file, due when the taxpayer exceeds the statutory debt-equity ratios – currently set at 2:1, or 5:1 for financial institutions.

Transfer pricing compliance activities by local tax administration

It is expected that Chinese tax authorities will increasingly rely on digital analytics and big data in order to monitor taxpayer activity and compliance. In the China Country Practice of the UN Manual, reference is made to the China Taxation Administration Information System (CTAIS), which combines individual taxpayer screening with industry analysis and data trends for specific markets or types of businesses. The system is based on red-flag indicators of risk and the following criteria will likely be used to select audit targets:

- Materiality of transactions or significant number of different categories of related-party transactions;
- Consecutive losses, low profitability or fluctuating profitability over a long period;
- Profit level below industry average;
- Mismatch between functional profile/profitability or benefits/costs allocated;
- Enterprises which have transactions with related parties in tax havens;
- Enterprises that failed to submit related-party filings or prepare transfer pricing documentation as per relevant regulations; and
- Enterprises that exceed the statutory related-party debt-equity ratios.

Through 2016, the SAT continued to invest in capacity building. Consistent with the increase in transfer pricing audits and competent authority procedures post-BEPS, the SAT hired 16 new resources in 2016 and 26 more are expected in the coming years. This will result in a dedicated team of approximately 50 resources at the SAT headquarters and approximately 500 inspectors involved in anti-avoidance across the country. In July 2016, the SAT set-up a new division (Unit 3), which will also support Units 1 and 2, primarily on APA and national joint-audits.



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Before joining KPMG China, Rafael worked as tax associate with a global law firm in the Netherlands between 2011 and 2015 and, prior to that, as head of tax with a Brazilian law firm.

Dispute resolution (including APAs)

With Announcements 64 and 6, China has introduced new guidance on both APA and MAP procedures, respectively. On APA, Announcement 64 introduces a revised, front-loaded procedure (with examination and evaluation processes being conducted before the formal application) and includes a priority list for acceptance of applications. The new regulation sets forth a 10-year limit for APA roll-back. In line with BEPS Action 5, Announcement 64 also includes an information exchange clause, according to which in unilateral APA signed after April 1 2016, the SAT is empowered to exchange information with tax authorities in the other country concerned, save for national security information concerns. Regarding MAP, Announcement 6 provides that applications may be denied for enterprises undergoing special tax investigations or which have not cleared tax payables after the conclusion of special tax investigations. Differently from Circular 2, which provided that applications must be made within three years of receiving transfer pricing adjustment notices, Announcement 6 makes general references to double tax treaties signed by China regulating the specific time limit on mutual agreement procedure applications.

MAP cases which have been accepted but not resolved by May 1 2017, will be subject to the provisions in Announcement 6.

In light of the material changes in the TP legislative framework, growing SAT anti-avoidance focus and increased level of transparency under BEPS, it has become even more critical to properly monitor and manage taxpayers' compliance with transfer pricing regulations, including timely and appropriate preparation of TP documentation and disclosure forms. Moreover, multinationals are advised to establish internal risk monitoring mechanisms and develop a consis-

tent risk mitigation approach. Going forward, the main pressure points for multinationals operating in China are expected to include: (i) mismatch between management accounts, tax accounts and group consolidated financial statements, (ii) overseas entities that retain a relatively high profit but have limited economic substance or with actual activities wholly or partly performed in China, (iii) significant outbound payments such as service charges, royalty payments or interest payments, (iv) disclosure and analysis for related party financing arrangements and equity transfers, and (v) insufficient documentation or supporting materials.

Imminent transformation in Hong Kong's transfer pricing landscape

By **Lu Chen** and **John Kondos** of **KPMG** in **Hong Kong**.

On October 26 2016, the Hong Kong government issued a consultation paper on a range of measures including, amongst others, a proposal to introduce specific transfer pricing (TP) rules for Hong Kong (HK). Following Action 13 of the OECD BEPS project, the Hong Kong government is expected to implement a statutory TP regime in Hong Kong, including the adoption of the three-tiered approach to TP documentation – master file, local file and country-by-country reporting (CbCR).

New Hong Kong TP framework

Overview

The Hong Kong government's priority is to put in place the necessary legislative framework for TP rules which cover the OECD transfer pricing guidance on value creation/intangibles (Actions 8-10), spontaneous exchange of information (EOI) on tax rulings (Action 5), three-tiered reporting requirements (Action 13) and cross-border dispute resolution mechanism (Action 14) as well as multilateral instruments (MLI) (Action 15).

This will provide a clear legal basis for the Hong Kong Inland Revenue Department (IRD) to address TP issues. As a result, TP in Hong Kong will likely evolve rapidly in response to the Hong Kong government's commitment to align with the OECD BEPS framework and international practices.

Applicability

As proposed, preparation of both master file and local file is required for enterprises meeting two of the following criteria – annual revenue exceeding HK\$100 million (\$12.8 million), assets exceeding HK\$100 million and workforce exceeding 100 employees. If the enterprise's consolidated group revenue exceeds the equivalent of €750 million (HK\$6.8 billion, \$836 million), it will have to prepare/have available a CbC report – this is in line with the OECD recommendation.

The TP regime will cover payments for assets and services, financial and business arrangements (e.g. loans) and cost contribution arrangements. Based on the definition of associated enterprise in the consultation paper, HK TP obligations will potentially apply not only to cross-border but also domestic transactions as well. This has resulted in significant industry pushback, many requesting that the new TP documentation requirements not extend to domestic transaction or be phased

in much later once companies have adjusted to the new international standards.

Penalties

Non-compliance with TP rules will render the tax returns incorrect. If there is no TP support, the penalties would follow those in respect of incorrect tax returns provided under sections 80, 82 and 82A of the inland revenue ordinance (IRO). As already stipulated in the IRO, penalties can be up to 300% of the tax undercharged.

TP enforcement/audits

Notwithstanding legislative developments, Hong Kong has already begun active TP enforcement. Companies in a number of industries have been challenged on a variety of related party transactions including IP/royalties. Common challenges are with respect to head office allocation/intra-group services where many financial institutions have also been queried. The most systematic enforcement activity has focused on the asset management sector where profit splits are consistently enforced and controversial challenges in areas such as carried interest persist. All the more demonstrating the IRD's change in mindset and their willingness to take on TP challenges and more rigorously enforce TP.

Dispute resolution (Arbitration/MAP and APA)

The HK BEPS consultation paper states that the MLI seeks to modify Hong Kong's existing comprehensive avoidance of double taxation agreements (CDTA) in order to "implement tax treaty-related BEPS measures in a synchronised and efficient manner." Further, Action 6 – Preventing Treaty Abuse and Action 14 – Improving cross-border dispute resolution mechanism is expected to be addressed in the context of MLI.

With the implementation of statutory TP rules, there will likely be an unavoidable increase in the number of cross-border treaty-related disputes. To address this, the Hong Kong government is proposing "to introduce a statutory mechanism to facilitate the handling of mutual agreement procedures (MAP) and arbitration cases in Hong Kong." If implemented, this could be a useful dispute resolution tool, but it is so far not yet clear what the Hong Kong Government is specifically intending. Naturally there is anticipation to see how this is addressed in the final legislation and guidance.

Other than MAP, KPMG professionals expect taxpayers will increasingly consider advance pricing arrangements (APA) to bring about more certainty in their intercompany pricing. In this regard, the Hong Kong government has expressed its intention to strengthen the APA regime by providing it with a statutory basis and making the programme more workable.



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

Lu 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.

Hong Kong Specific BEPS issues

There are a number of BEPS issues that will affect companies and entities operating in HK. However there are a few notable potential BEPS areas worth elaborating below.

Offshore tax regime

Making offshore claims under Hong Kong's territorial tax system will require corporates to exercise greater care as it could potentially come into increasing conflict with TP regulations. While there is a legitimate basis to make offshore claims in Hong Kong under certain circumstances, Hong Kong corporates will need to carefully consider how this may reconcile with their TP policies and how best to mitigate any potential challenges arising from these arrangements. Those making offshore claims will need to start asking themselves:

- Are there any economic activities or substance in Hong Kong?
- Could this lead to red flags when filing a country-by-country report?
- Is the profit concerned subject to tax in another jurisdiction?



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Having lived and worked in Asia for over 15 years, John has extensive experience in TP issues across the region with respect to Japan, Korea, Hong Kong, Singapore, Taiwan, China, India, Indonesia, Philippines, Vietnam, Thailand and Australia.

- Does it create a permanent establishment exposure in a jurisdiction outside of Hong Kong?

Under BEPS, one key concern is foreign tax authorities seeking to tax for themselves Hong Kong offshore income. To address this challenge it is recommended to thoroughly review and address the TP arrangement. By first verifying the arm's length income due to Hong Kong and confirming the appropriate arm's length income that remains in other overseas jurisdictions will help establish that the income recognised in Hong Kong for TP purposes is correct. On that basis any Hong Kong offshore claim applied to the income allocated to Hong Kong is then a matter of Hong Kong domestic tax law and practice.

Clearly there will be many challenges ahead and companies are strongly encouraged to seek TP and corporate tax advice appropriate to their particular facts and circumstances. To help mitigate risk and address appropriately, companies will need to take careful steps to establish their corporate tax/TP positions and put in place a well-established framework.

Intangibles – form and substance

The OECD Transfer Pricing guidance, as revised by Actions 8-10 (i.e., aligning TP outcomes with value creation – adopted by Hong Kong) has wide ranging implications. In the past, the transfer pricing of intellectual property typically focused on the legal ownership first then on the economic

ownership (the principal developer). However, the new definition of intangibles under the OECD BEPS project encompasses a much broader scope of functions, namely development, enhancement, maintenance, protection and exploitation (DEMPE). With this broader definition, there is expected to be increased controversy as to how intangible-related income is shared within a multinational group.

Hong Kong is a regional hub for many multinational groups supporting Asian regional activities. For the most part this is limited to coordination and routine support but in some cases this may extend to non-routine functions or DEMPE activities. Taxpayers in Hong Kong will need to make an increased effort to bolster their documentation by clarifying the nature of activities performed in Hong Kong and by related parties outside Hong Kong in order to minimise misinterpretation and avoid unnecessary and protracted tax disputes.

Additionally, the Hong Kong government is engaging in initiatives to foster creativity in intellectual pursuits (e.g., innovation and technology). In response to this and also resulting from supply and value chain operation led restructures, IP migration and IP issues are becoming more pertinent to Hong Kong. Naturally this will necessitate additional TP vigilance by Hong Kong taxpayers.

Corporate treasury centre

Intra-group financing arrangements now form a key part in the TP master file under the OECD BEPS initiatives. Together with the increase in information transparency, these arrangements now need to be properly supported and documented. Companies must assess the robustness of these arrangements and determine an appropriate group financing structure.

Relevant to Hong Kong are the newly introduced Corporate Treasury Centre (CTC) incentives by which Hong Kong is promoting itself as a potential regional treasury hub. To support any treasury hub and any financial transactions in general that relate to Hong Kong, it will become necessary to build additional TP support not just of the interest rate charged, but also on arm's length conditions and appropriate levels of deduction based on capital structure (e.g., debt-to-equity ratios, and possible thin capitalisation).

Preparing for the future

Once Action 13 is fully implemented, the Hong Kong tax authorities will clearly have access to more taxpayer information via the aster file and CbC report and will be able to examine those documents in conjunction with the local file. With greater transparency and awareness of the group as a whole, KPMG professionals expect this would lead to added scrutiny and an increase in challenges from the tax authorities.

As such, taxpayers will need to bolster their Hong Kong local TP files to better reconcile the facts and/or put the local facts in the proper context. If they have not done so already, Hong Kong taxpayers with related party dealings

will need to formalise and document their TP arrangements with related parties in light of the forthcoming legislation in line with BEPS principles, and are recommended to do so early enough to be sufficiently ready in time.

Dawn of a new era of transparency and trust

By **Rahul Mitra** of
KPMG in India.

Ever since transfer pricing (TP) was introduced in India in 2001, it has become the single largest source of tax disputes and litigation for MNCs operating in India, thus positioning the Indian Revenue Service as one of the toughest revenue administrators in the world. However, the scenario has undergone a sea change over the last three years, particularly post the advent of the current government, where the Indian Revenue Service has been striving to tone down the rigours of TP audits; and also settle disputes through the machineries of advance pricing agreement (APA) and mutual agreement procedure (MAP).

Recent legislative amendments

The Indian government has introduced three major legislative amendments to the TP regulations over the past year, namely:

1) Master file and country-by-country (CbC) reporting

In line with OECD/G-20 BEPS Action plan 13, the Indian government has introduced the concepts of master file and CbC reporting with effect from fiscal year beginning on April 1, 2016, vide the union budget 2016-17. The requirement of preparing local documentation files has been in vogue in India since 2002. Though the detailed guidelines around master file and CbC reporting are yet to be released by the government, they are expected to be in line with BEPS Action plan 13, as above. The government has also made it clear that the monetary threshold for CbC reporting would be retained at that prescribed level under BEPS guidelines, namely the Indian Rupee equivalent of €750 million (\$836 million). The first compliance for master file and CbC reporting is due on November 30 2017.

2) Secondary TP Adjustment

The Indian government has introduced the concept of secondary TP adjustment, vide the union budget, 2017-18, to be applied to primary TP adjustments made in the hands of taxpayers for fiscal years beginning on or after April 1 2016. Under the scheme of secondary TP adjustment, the primary TP adjustment would be deemed to be an advance given by the Indian taxpayer to its foreign associated enterprise (AE); and if the same is not repatriated to India within a prescribed timeline, an amount of interest income would be imputed in the hands of the Indian taxpayer in the form of a secondary TP adjustment. The scope for secondary adjustment has been extended to resolutions under APAs and MAPs, safe

harbours, apart from determinations under TP audits; and also suo moto offerings by taxpayers in tax returns. The detailed guidelines around secondary TP adjustments, namely the time frame for repatriating the money represented by the primary TP adjustment, manner of calculating the interest income, including rate of interest to be applied, etc., are expected to be released by the government shortly.

3) Limitation of interest deductions

In line with BEPS Action plan 4, the Indian government has introduced, vide union budget, 2017-18, a provision for limitation of interest deductions in the hands of Indian taxpayers or permanent establishments of foreign companies, with respect to interests paid on loans taken from overseas AEs; or on loans taken even from third party lenders, which are either guaranteed (explicit or implicit guarantee) or backed by advanced placed, by overseas AEs, up to 30% of earnings before interest, depreciation, tax and amortisations (EBIDTA). While the disallowance of interest would be made only with respect to loans taken either from or involving overseas AEs, as above, for the purposes of computing the overall limit of 30% of EBIDTA, even interests paid on rank third party loans, namely without involvement of any overseas AE whatsoever, would be taken into account. The amount of interest so disallowed in any fiscal year, may be carried forward for a maximum period of eight years, for being allowed as deduction in subsequent fiscal years, subject to satisfying the overall criterion of 30% of EBIDTA in such subsequent fiscal year. The provisions for limiting deduction for interests apply on and from fiscal year beginning April 1 2017. Banks and insurance companies have been kept outside the ambit of such provisions.

Revised/updated country chapter for United Nations (UN) TP manual

The Indian Revenue has recently updated its country chapter, for being appended with the revised UN TP manual. As such, the Indian Revenue has not released any official circulars or guidelines on TP to this date, except for the one on contract research and development (R&D) services, which was issued in March 2013. Thus the country chapter appended with the revised UN TP manual, at least provides some insights on the mindset of the Indian Revenue in dealing with some of the complex issues relating to TP. The revised or updated country chapter has certainly demonstrated positive and progressive thinking on the part of the Indian Revenue on critical areas, e.g. marketing intangibles, location savings, etc., while on some of the other matters, there is scope for further rationalisation. The views of the Indian Revenue on some of the issues are discussed below:

1) Overall acceptance of recommendations of OECD/G-20 BEPS Action plans 8 to 10

The Indian Revenue has stated that it overall endorses the recommendations of BEPS Action plans 8 to 10, dealing with TP, except for the ones with respect to low value-adding intra-group services (IGS), as the Indian Revenue considers IGS to be a serious issue of possible base erosion.

2) Marketing intangibles

- a) It appears that for the first time, the Indian Revenue is keen to address the issue on marketing intangibles under the economic fundamentals of TP, by moving away from the arbitrary manner of inflicting routine adjustments, which has been the norm in the last six or seven rounds of TP assessments.
- b) The Indian Revenue states that compensation for advertisement, marketing and sales promotion (AMP) functions need not be separate; and can be part of the price of another transaction. Further, where the licensee of the brand performs AMP functions with the intention to exploit the results itself, obviously in the capacity of the economic owner of the marketing intangibles, then no separate compensation is required to be paid in favour of the licensee taxpayer, as understandably, the licensee taxpayer would have enjoyed; or be enjoying, the fruits from the market itself.
- c) Thus, the Indian Revenue appears to have finally accepted and acknowledged the concept of economic ownership of marketing intangibles, by the licensee of trademark, something, which it had been refraining from doing for the past several years. Incidentally, this had been the fulcrum of most of the disputes on the relevant issue, particularly for entrepreneurial licensed manufacturers and buy-sell companies, and also for normal risk-taking marketing distributors. Such acknowledgement on the part of the Indian Revenue, even though quite late in the day, but thankfully not late enough to make the scenario irretrievable, is indeed laudable.
- d) In case the Indian Revenue sticks to such a correct fundamental approach towards TP, then the entire litigation around the issue of marketing intangibles, which is currently pending before the Supreme Court, more on legal grounds, namely the presence of international transaction or otherwise, with respect to AMP expenditure incurred by licensees of brands, under the fact pattern of TP adjustments made to this date, would actually be put at rest on positive terms.

3) Location savings

- a) It is heartening to note that the Indian Revenue has come out of its earlier stand, as reflected in the earlier version of the country chapter, to now acknowledge that location specific advantages (LSAs) and location savings, which the Indian economy might provide to overseas



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Prior to joining KPMG in India, Rahul was the national leader of PwC India's transfer pricing practice between 2010 and 2014. Rahul was a partner in the tax practice of PwC India between 1999 and 2014.

Rahul has 25 years of experience in handling taxation and regulatory matters in India. He specialises in inbound and outbound planning assignments, value chain transformation or supply chain management projects, and profit attribution to permanent establishments.

Rahul independently handles litigation for top companies at the level of the Income Tax Tribunals. Some of the major wins of Rahul before the tax tribunals in transfer pricing matters have been setting precedents, both in India and globally, such as BMW India marketing intangibles in the case of distributors, and GAP India remuneration model for procurement services company, addressing issues of Berry Ratio & location savings.

In his personal capacity, Rahul has handled several APAs in India, involving clients from across industries; and also covering complex transactions, e.g. industrial franchise fees/variable royalties under non-integrated principal structures; contract R&D service provider model; distribution models, with related marketing intangible issues; and financial transactions.

Rahul has been a paper-writer and speaker in several tax conferences held in India and abroad. Rahul is a member of the global editorial board of the magazine Transfer Pricing Forum published by Bloomberg BNA. He has been a visiting faculty of the National Law School in the subject of transfer pricing and international tax treaties.

Rahul was the country reporter on the topic non discrimination in international tax matters, for the IFA Congress held in Brussels in 2008. Rahul was invited by the OECD to speak at the 2012 Paris roundtable conference on developing countries' perspectives on APAs.

MNCs, who have set up businesses in India, would stand duly subsumed or factored in, the results of proper local comparables selected for determining the arm's-length price of transactions entered into by the Indian subsidiary companies with their overseas AEs, where typically the Indian subsidiary companies would be acting as service providers of their overseas related parties.

- b) The Indian Revenue has clarified that if such proper local comparables can be identified, then no further upward adjustment on account of premium profits, if any, emanating out of LSA or location savings, being referred to as location rent in TP parlance, would need to be made to the results of the Indian taxpayers.

Developments around APAs

- 1) Post the introduction of the APA programme in 2012, the Indian Revenue has resolved more than 150 APAs until March 2017 in a most non-adversarial manner through congenial negotiations with taxpayers and revenue authorities of other countries.
- 2) Taxpayers have reposed significant confidence in the new image of the Indian Revenue, as manifested in the APA programme; and have filed more than 800 APA applications over the last five years.
- 3) The Indian Revenue has recently released a report on the progress of the APA programme until March 2017. KPMG in India had conducted a survey within the industrial community for gathering the views of the industry on the success of APA programme; and also suggestions for the improvement thereof. The results of the APA survey were relayed to the Indian Revenue, who listened to the feedback and suggestions with care and interest; and gave their comments as well. KPMG thereafter released the APA survey 2017, being one of the first of its kind in India, incorporating the views and suggestions of the industrial community; and also comments of the Indian Revenue.
- 4) Approximately 85% of the APA applications filed till date have been unilateral ones. The relative slow progress of the bilateral APA programme can be ascribed to the following reasons:
 - a) The largest trade partner for India, namely US, had initially distanced itself from accepting requests for bilateral APAs involving India, in view of the long pendency of bilateral MAP cases. However, pursuant to India proactively resolving more than 100 MAP cases with US during 2015, US finally agreed to accept applications for bilateral APAs from early 2016.
 - b) The Indian Revenue had taken a unique stand that absent the provisions of corresponding adjustment, being equivalent to the ones contained in Article 9(2) of the OECD Model Convention, in a tax treaty signed by India with any country, the Indian Revenue would not entertain bilateral APA or MAP involving

such country. As a result of the said stand, several important countries, having significant trade with India, had been outside the ambit of the bilateral APA programme, as their tax treaties with India did not have such clause of corresponding adjustment in TP, namely Italy, Germany, France, Korea, Singapore, etc.

- c) Incidentally, India has recently renegotiated its tax treaties with Singapore and Korea, as a result of which, the relevant clause around corresponding adjustment has been incorporated within such treaties effective April 1 2017. Thus, on and from such date, the corridor for bilateral APAs have opened up between India and the said countries.

- d) Out of the approximately 150 APAs signed till March, 2017, 11 APAs were bilateral, involving UK and Japan. It is expected that the traction on bilateral APAs would increase manifolds in the days ahead.

The environment of TP in India is looking better than ever before. As would appear from the discussions above, the Indian Revenue has responded well to the faith and trust reposed by taxpayers on the tax administration, by streamlining policies, taking positive stands on critical issues in TP; and also resolving disputes in an upfront and non-adversarial manner. Thus, the entire environment around TP in India is transforming into one of mutual trust and confidence between taxpayers and the Indian Revenue.

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Taking the lead in BEPS implementation

By Iwan Hoo and
Collin Goh of KPMG
in Indonesia.

Although Indonesia has had transfer pricing-related provisions in its tax legislation for many years, the Indonesian Tax Office (ITO) started to introduce transfer pricing regulations and guidance only around 2009. These were followed by a number of regulations giving more guidance to taxpayers and tax auditors alike. These regulations were in line with the OECD guidelines, in particular when the hierarchical approach to the choice of the transfer pricing methodology was replaced by a “best method” approach in the second edition of the transfer pricing regulations.

Introduction of BEPS Action 13

However, the year 2016 ended with a big bang when Indonesia introduced BEPS Action 13 in its local regulations on December 30 2016. This new regulation, PMK-213 is not surprising in itself as it required the preparation of three documents regarding related-party transactions:

- A master file (MF), containing general information on the group;
- A local file (LF), containing specific information on operations in Indonesia; and
- A country-by-country reporting file (CbCR), containing detailed financial and other information on each of the members of the group.

The MF and LF must be available upon request four months after each fiscal year end, in Bahasa, Indonesia. The CbCR submission – more on this later – is due within one year after the fiscal year end.

This sudden and immediate implementation caused a number of issues for Indonesian taxpayers. Not only was the deadline for the LF very short; in practice a lot of international groups have issues with their master files which in most jurisdictions were due much later. In addition, the requirement to have the documents available in the local language caused additional burdens, both with regard to the time required to complete the transfer pricing documentation, but also with regard to the effort itself.

Thresholds for preparing and maintaining master files and local files

MFs and LFs are mandated if a taxpayer meets any of the following thresholds in a fiscal year (some of the explanations are KPMG professionals’ view on this regulation):

- A taxpayer conducting:
 - Any related-party transactions and its gross revenue was above IDR 50 billion (\$3.7 million) in the previous year (in this case 2015) – there



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He moved to Indonesia when local transfer pricing regulations were issued and has experience in all relevant sectors in Indonesia, as well as dispute resolution and APAs.

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is no threshold on the total amount of related party transactions; or

- Related-party tangible goods transactions (sale and purchase of goods, materials, etc.) of more than IDR 20 billion (\$1.5 million); or
- Related party non-tangible goods transactions (interest, royalties and/or services) of more than IDR 5 billion (\$370,000), or
- Related party transactions of any amount with a related party in a jurisdiction which has a corporate tax rate lower than Indonesia's corporate tax rate, currently 25%. As there is no threshold for the level of the related-party transactions, all, however small, are covered under this provision. A list of countries meeting this criteria has been published by the Indonesian Tax Office (ITO).

The level of these thresholds in practice has caused some complications as many groups that are not required to prepare master files under their local legislation must prepare MFs for Indonesian purposes.

The information to be included in the MF seems similar to the OECD recommendations and includes:

- The structure and chart of ownership, including the country or jurisdiction of each affiliated party;
- The business activities conducted by each affiliated party;
- Intangible assets owned;
- Financial and financing activities; and
- Consolidated financial statements of the parent entity and taxation information related to affiliated transactions.

The LF information also seems in line with the OECD recommendation and includes:

- The business activities conducted by the taxpayer;

- Information on the related-party transactions and transactions with independent parties;
- Explanation of the application of the arm's-length principle;
- Financial information on the taxpayer; and
- Non-financial events which affected the price or profit level.

However, the Indonesia requirements are in practice more extensive – both for the MF and the LF – so that international groups have to provide additional information in their master files to satisfy the Indonesian requirements, in particular with regard to intangible assets. Also, the fact that there is no threshold for transactions with countries with a tax rate lower than 25% adds an additional burden for taxpayers as some major jurisdictions are included, such as Malaysia, the UK, Switzerland and Singapore.

The main issues for the LFs are related to extensive disclosure requirements on the business activities of each group company rather than the group as a whole. Minor issues relate to the disclosure of shareholders since this may not always be possible for publicly listed companies.

Thresholds for preparing and maintaining CbCR files

A CbCR is mandated if a taxpayer meets either of the following thresholds in a fiscal year (some of the explanations are KPMG professionals' views on this regulation):

- It is a parent entity with consolidated group revenue of more than IDR 11 trillion (\$814 million) which applies to Indonesian group companies; or
- It is a part of a foreign parent entity that (i) is not required to submit a CbCR, or (ii) is in a country that does not have an information exchange agreement with Indonesia or (iii) if the ITO is unable to obtain a CbCR through an information exchange agreement.

The ITO has published a list of countries that do not have a suitable exchange of information arrangement with Indonesia. One of the major jurisdictions that has not signed up is of course the US.

However, implementing regulations with regard to the CbCR are still expected and hence changes are still expected.

Penalties

A taxpayer that falls under the above requirements has four months (12 months for CbCR) after each financial year end to prepare and declare, starting in its 2016 corporate tax return, that it is ready to submit the MF/LF. The MF/LF must be summarised in an attachment to the annual corporate income tax return (CITR) and the CbCR attached to the tax return of the following year.

Penalties exist for failing to prepare and submit the MF/LF upon request. Failure to prepare MF/LF is treated under Article 3(3) as not applying the arm's-length principle, which could trigger major penalties. Failure to deliver

MF/LF when requested would result, under Article 5(3), in the taxpayer being deemed as not having transfer pricing documentation. An adjustment as a result of the ITO making a transfer pricing analysis on their own would attract a penalty of 2% per month, but this penalty applies to any adjustment. Hence being late would still put the taxpayer in a better position than having no transfer pricing documentation at all.

The ITO can request the above documents for compliance checking, a tax audit, an objection, a reduction of an administrative sanction and in other cases.

Transfer pricing compliance activities by local tax administration

Under the Indonesian tax system, any taxpayer who files a refund request is subject to a mandatory tax audit. This will almost always include an audit of the transfer pricing policies and may lead to substantial adjustments. This is not only triggered by the usual dispute areas such as services and royalties, but also by challenging economic analyses.

Dispute resolution (including APAs)

On a positive note, the Indonesian Directorate General of Taxation has been very active promoting APAs and MAPs and has gone through the effort of visiting major trading partners. Negotiations with many countries are underway. However, unlike other jurisdictions, Indonesia does not publish data on how many APAs/MAPs have been concluded or what type of transactions are covered.

Indonesia has gone through a major change in its transfer pricing regulations by introducing the MF/LF concept. The information to be disclosed is much more extensive than in



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He qualified as a chartered accountant and holds a Master of International Tax from the University of Melbourne and a Master of Law (Juris Doctor), and also a PhD from Monash. Collin has been providing transfer pricing services to all industries including the energy & resources sector. He enjoys assisting clients to prevent, mitigate or resolve transfer pricing risks and disputes and is able to do so fluently in both English and Chinese.

the past and as required by the OECD. It still remains to be seen what will be exactly required for the CbCR, pending the issuance of the implementing regulations. However, only time will tell what will be the exact impact of these new regulations on taxpayers during tax audits.

Latest update of transfer pricing in Japan

By Jun Tanaka,
Nobuhiro Tsunoda
and Yosuke Suzaki of
KPMG in Japan.

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 a rapidly 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, it is also expanding the taxation base, including the removal of tax deductions and shifting the tax base from direct tax to indirect tax (i.e. 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 tax revenue. In particular, Japanese tax authorities pay much attention to whether 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. As a result, TP is one of the hottest topics areas in Japan.

Changes to (or introduction of) local transfer pricing legislation (including regulations)

In order to solve international taxation issues including transfer pricing, Japanese tax authorities expressed the need to coordinate 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 13.

In Japan, there was a TP documentation rule but it was not a contemporaneous TP documentation rule. The new TP documentation rule based on the BEPS Action 13 was introduced from (the fiscal year 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) in electronic format within one year from the fiscal year end of the parent company, and also to prepare the local file by the timing of a taxpayer's tax return filing date from the fiscal year starting at April 1 2017.

BEPS-related developments

Before preparing the local file, it is necessary to understand clearly the threshold of transaction amount. The new Japanese transfer pricing

documentation rule indicates that a taxpayer engaged in either (1) Controlled transactions whose total amounts for the previous business year was JPY 5 billion (\$44.8 million) or more, or (2) transactions of intangibles whose total amount for the previous year was JPY 300 million or more with one foreign-related party must prepare the local file by the deadline for submission of tax return. However, this threshold does not guarantee of exemption from the local file. Even if the above threshold is not met, taxpayers are supposed to submit their local file when the tax authority requests the local file during a tax audit. Therefore, regardless whether the thresholds are met, it would be advised for the taxpayer to review and assess the transfer pricing risk for the overall foreign related-party transactions and prepare the local file.

When a tax payer works on the local file, there are some major potential issues. One of the major issues is the treatment of intangible assets. Even if no agreements regarding intangible properties have been entered among related parties, it is generally found in the situation that intangible assets are utilised by foreign related parties and the remuneration for the use of intangibles are added on prices in other related party transactions such as sales or purchase of tangible goods. Therefore, taxpayers need to understand the overall picture of transaction, functions and risks each party bears, intangible assets employed, and impact of intangible assets in the transactions before concluding transfer pricing methodologies of relevant transactions described in the local file.

Also, maintaining consistency is another issue. Taxpayers are expected to be consistent with the information described in the master file as Japanese tax authorities will check explanations in the local file such as the definition of the business model, value chain analysis, and intangible assets, and ensure that information corresponds with those in the master file and the CbC Report.

In addition, many taxpayers may use transactional net margin method (TNMM) as the primary transfer pricing method and simply test the overseas subsidiaries margin in the local file. However, it is important to review the profit allocation among related parties even if TNMM is the primary transfer pricing method.

Transfer pricing compliance activities by local tax administration

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 have strengthened. Also, the intangible transactions including royalty payment as well as services transactions are one of the major target areas at the tax audit with reflecting the arguments of the BEPS Action 8 to 10.



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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.

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, the rapid increase in the number of tax audits and tax assessments for intangible or service transactions with foreign related parties located in these countries are one of the major characteristics in recent Japanese TP audits.

Also, it can be observed the target of TP audits has recently shifted to small and medium-sized companies including foreign companies' subsidiaries. According to the outline of actual audit results for corporate tax and others, released by the National Tax Agency (NTA), the number of TP assessment cases was 218 in FY2015 (the year ended in June 2016). However, the TP assessment amount was JPY 13.7 billion, which was continuously decreased. As a result, the average TP assessment amount per case was below JPY 100 million (in FY2015 JPY 63 million, but in FY2013 the amount per case was JPY 320 million).

This situation indicates the big cases at multinational companies have already gone around and these large com-



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He has advised clients on matters in the areas of transfer pricing planning study, TP documentation, APAs, competent authority, cost sharing, IGS cost allocation, and examination issues. Also, he is a specialist of valuation and economic analysis such as intangible and businesses valuation and business planning.

panies have taken preventive measures, most commonly TP documentation and advanced pricing agreement (APA), but small and medium-sized 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 FY2011, 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-sized companies. The increased number of target companies for transfer pricing audits will lead to an increase in the number of TP assessment cases and a 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 3,362 and the tax assessment amount is JPY 230.8 billion (including TP assessment) in FY2015, which is significantly larger than the TP assessment amount statistics. In addition, since the statistics do not include any voluntary tax adjustment by tax payers, the actual number of cases and tax 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.

Dispute resolution (including APAs)

In Japan, APA is one of the popular options to avoid potential TP risk and enhance predictability as well as transparency of taxation. Also, tax audits in Japan are made periodically, and the level of tax audits is normally much more detailed. The 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 FY2015, the number of APA applications increased to 134 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 characteristic of APA/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 the 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 (e.g. 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 treaties. The number of tax information exchanges is about 300,000 each year for the past several years.

Other relevant updates

The Japanese tax authority updated international tax regulations including transfer pricing. In the 2017 tax reform, the Japanese CFC regime was extensively amended in light of the final report of Action 3 (designing effective controlled foreign company rules) of the BEPS Project.

Conclusion

In Japan, taxation for international transactions has been enforced for recent years. In the area of transfer pricing, since BEPS TP documentations are newly introduced and tax information described in the master file and CbC report will be shared among related countries' tax authorities, it is more important for any taxpayers in Japan to understand the tax position of all group companies, to check potential TP risk, to keep consistency of transfer pricing policy within the group, and prepare relevant files.

Buckle up!

By Bob Kee and
Chang Mei Seen of
KPMG in Malaysia.

The transfer pricing climate in Malaysia over the past 12 months has been abuzz with activity. In addition to BEPS-related developments (which are pretty much moving in line with other major jurisdictions), KPMG professionals have also seen some significant changes within the Malaysian Inland Revenue Board (MIRB), as well as an increased emphasis on transfer pricing compliance not just by the MIRB but also by other local regulators.

Transfer pricing enforcement

The Malaysian government has appointed a new CEO of the Inland Revenue Board whose term took effect from December 12 2016. Since then, KPMG professionals have noticed an enhanced MIRB approach to audits and an increased focus on aggressive tax planning structures.

A special team – the LHDN tax investigation team 2017 was set up in December 2016. It comprises 272 intelligence officers and tax investigators who look into tax evasion, increasing compliance and managing gaps in tax, as well as increasing the country's direct tax collection. It was also reported that part of this team's focus is to audit multinational corporations (MNC) that transfer their profits to countries with lower tax regimes as a means of base erosion, causing a loss in income to the country. The team's aim is to achieve a tax collection of RM 2 billion (\$467 million).

Recent publications in local media also report that the MIRB is currently conducting tax audits and investigations on 30 large enterprises, and is looking at clawing back some RM 1.9 billion in additional taxes and penalties. Out of these 30 enterprises, most are Malaysian companies, with one or two multinationals. Although the RM 1.9 billion might not be fully due to transfer pricing non-compliance, it is still daunting to know that the MIRB had focused its attention on so many local large enterprises in a relatively short period of time. This gives us a glimpse of the tax enforcement environment in the near future, as well as the degree of seriousness the MIRB is taking on tax compliance.

Attention and involvement of other regulators

In August 2016, the Central Bank of Malaysia (Bank Negara Malaysia – BNM) issued a direction to all licensed locally incorporated foreign banks, locally incorporated foreign Islamic banks, and all insurers and Takaful operators. This direction addresses the payment of intercompany charges, where BNM expects that these intercompany charges are



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governed by a comprehensive service level agreement (SLA) and complying with the MIRB's transfer pricing guidelines.

Subsequently, in March 2017, BNM issued a supplementary direction to clarify that the external auditors are expected to validate and certify the intercompany charges paid, in the form of review engagement and agreed-upon procedure reports. These reports are to be submitted to the board of the licensed financial institutions, to be deliberated and agreed upon prior to the board submitting to BNM.

The above letters are the first transfer pricing related direction issued by a regulator other than the MIRB. Historically, little attention on transfer pricing was paid to financial institutions as they are governed by strict regulations imposed by BNM. However, this recent development shows that financial institutions can no longer gloss over their intercompany charges, and must pay more attention on the arm's-length nature of their intercompany payments.

In addition, other regulators have also teamed up with the MIRB. The tri-partite effort consisting of the MIRB, BNM and the Malaysian Anti-Corruption Commission (MACC) hopes to strengthen the country's financial system, increase national revenue and fight corruption and abuse of power through the exchange of information between these three agencies. With the free exchange of information between these three parties, tax compliance enforcement is expected to tighten significantly. It should also be highlighted that this is in addition to the existing cooperation that MIRB already has in place with the Malaysian Royal Customs Department.

Transfer pricing audits

As mentioned, KPMG professionals have noticed enhanced strategies adapted in tax audits. Previously, tax audits were specialised, i.e. a specific unit would handle corporate tax audits, whilst another unit would handle transfer pricing audits. However, in recent months KPMG professionals have noticed that the MIRB no longer conducts specialised audits, and letters which usually precede tax audits do not just request for the usual documents relating to corporate income taxes, but also include a request for the submission of the company's transfer pricing document as well as a summary of the company's intercompany financing details. This is also a shift in focus, as transfer pricing was previously predominantly targeted at MNCs. With this change, it is obvious that the MIRB is stepping up and looking into transfer pricing compliance in Malaysian corporations and also intercompany financing transactions.

KPMG professionals have also noticed a new trend in the MIRB's audit letters, where the MIRB is currently requesting details in relation to intercompany borrowings. This seems to be a clear signal on the MIRB's attention to intercompany financing, especially on interest-free financing between corporations. Corporations with intercompany lending and borrowings should relook into their financing arrangements and take steps to ensure that intercompany financing complies with the arm's-length principle.

Based on the MIRB's 2015 annual report, total tax collection in 2015 was RM 121.2 billion. Table 1 depicts the MIRB's tax collection specifically from transfer pricing audits from 2012 to 2015.

Table 1: Transfer pricing audits resolved

	Taxes and penalties (RM million)	No. of cases resolved
2012	116.4	78
2013	160.6	156
2014	155.9	168
2015	124.9	250

The number of transfer pricing audit cases resolved by the IRB has been increasing year on year, which corresponds with the increase in the headcount of its transfer pricing team.

In a media release dated April 17 2017, the MIRB has also released a statement on the imposition of penalty at a rate of 100% for the offence of undeclared or under-declared income which is subject to tax. This increased rate will take

effect from January 1 2018, and is a steep increase from the current imposed general rate of 45%. For transfer pricing cases, the current penalty rate imposed is 35% (25% if transfer pricing documentation has been prepared) but KPMG professionals are expecting new penalty regime to be announced soon.

Dispute resolution

KPMG professionals have also in recent years seen an increase in the number of taxpayers appealing against tax audit findings through the judicial system through the submission of the form Q to the dispute resolution panel (DRP). The DRP is divided into two units, which are the Tax Resolution Department and the Tax Litigation Department. The MIRB's 2015 annual report shows the statistics listed in Tables 2 and 3.

From these tables, it is clear that the number of taxpayers appealing through the judicial system and the number of cases resolved at the Tax Resolution Department have been increasing, which is encouraging as it shows the success of this independent group of legal counsel in the

Table 2: Form Q – Tax Resolution Department

Appeals (No. of applications)	Income tax for companies	
	2015	2014
In progress (b/f from previous year)	190	67
Filed in current year	362	331
Total	552	398
Resolved	450	208
In progress (c/f to following year)	102	190

Table 3: Form Q – Tax Litigation Department

Appeals (No. of applications)	Special Commissioner of Income Tax		High Court		Court of Appeal	
	2015	2014	2015	2014	2015	2014
In progress (b/f from previous year)	267	197	61	47	36	44
Filed in current year	268	196	15	22	12	12
Total	535	393	76	69	48	56
Resolved	175	126	12	8	13	20
In progress (c/f to following year)	360	267	64	61	35	36

Table 4

	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 RM 3 billion and above as at FY 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

MIRB to re-evaluate cases which could not be resolved between the tax officers and the taxpayers.

Mutual Agreement Procedure (MAP)

According to MIRB's 2015 annual report, there were no new MAP applications in 2015. However, it has been reported that there has been in total six MAP applications which have been processed, where one has been concluded. The existing cases involve four countries and touch on various issues such as transfer pricing, technical fees, bilateral APA applications as well as representative office.

Base Erosion and Profit Shifting (BEPS)

Since the release of the 13 Actions by the OECD, the MIRB has indicated that Actions 8-10 and 13 would be the MIRB's main focus for the time being. This is evidenced by the release of the final rules in relation to country-by-country reporting (CbCR), which is effective January 1 2017. The newly introduced rules apply to Malaysian-parented multinational corporation (MNC) groups with total consolidated group revenue of at least RM 3 billion in the financial year (FY) preceding the reporting FY. For example, for an MNC group with financial year ending December 31 2017, the total consolidated group revenue as of December 31 2016 will be

considered for determining whether the MNC group exceeds the threshold.

The information submission mandated by the rules will be in the form of the CbC report to be submitted to the Director General on or before 12 months from the last day of the reporting FY. The content of the Malaysian CbCR is the same as the CbCR recommended by the OECD.

A summary of CbCR requirements for companies operating in Malaysia are presented in Table 4.

In general, the new rules align closely with the report on Action 13 of the OECD and Group of Twenty ("G20") BEPS Project in relation to CbCR. Although the rules pertaining to master and local files have not yet been released, the MIRB has indicated that the revised transfer pricing guidelines which will cover information regarding master and local file requirements would be released any time now.

In summary, 2017 promises to be an extremely challenging year ahead with the anticipation of the revised transfer pricing guidelines as well as BEPS-related developments. From the MIRB's activities in the first few months of 2017, it is clear that the MIRB is stepping up and taking a more active role in terms of tax compliance and clamping down on aggressive tax planning. Therefore, both local corporations and MNCs should relook into their intercompany transactions and tidy up if necessary, before the MIRB comes knocking.

New Zealand Inland Revenue proposes new weapons in its transfer pricing arsenal

By Kim Jarrett,
Kimberley Bruneau
and Jordan Taylor of
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Zealand.

The years 2016 and 2017 have seen unprecedented levels of change in the New Zealand transfer pricing landscape. KPMG professionals have observed significantly increased audit activity of multinationals, evidence of increased information sharing between tax authorities, in addition to which three consultation papers were released in March 2017 which seek to impose far reaching changes to the New Zealand transfer pricing legislative environment.

As a consequence, multinational entities operating in New Zealand are now exposed to a much higher level of uncertainty and risk, and will need to ensure that they have appropriate and robust transfer pricing documentation in place which supports pricing models implemented.

New BEPS legislative measures announced

In March 2017 the New Zealand government released three consultation papers proposing changes to New Zealand's transfer pricing, permanent establishment and thin capitalisation legislation. Not only do these measures seek to align New Zealand with the prevailing position of many global tax authorities in relation to the ongoing BEPS measures, they appear to go further, adopting many of the rules recently introduced in Australia on re-characterisation and permanent establishment avoidance.

As a consequence of these rules, KPMG professionals expect increased disputes between taxpayers and Inland Revenue. It would therefore be prudent for multinationals operating in New Zealand to ensure they have worked through the implications of proposed rules for their transfer pricing operating models.

While still subject to consultation, final rules are expected to be issued at some stage after the New Zealand general election in September 2017, with application anticipated to be from April 1 2019 (for March balance dates).

Key proposals are discussed below:

1) New Zealand transfer pricing changes:

The proposals are aimed at strengthening New Zealand's transfer pricing rules by:

- Allowing Inland Revenue to disregard transfer pricing arrangements where legal form does not align with economic substance. This will effectively allow Inland Revenue to re-characterise transactions to impute what it considers to be arm's length conditions;
- Shifting the burden of proof for transfer pricing disputes from Inland Revenue to taxpayers, and extending the period Inland Revenue can

challenge a transfer pricing matter to seven years (from the current four years); and

- Increasing Inland Revenue powers to access information, including allowing it to issue an adjustment to large multinationals that are uncooperative based on the information available at the time. This will still be subject to the normal disputes process, although it is proposed that the disputed tax will need to be paid earlier in the process.

The introduction of a transfer pricing re-characterisation rule is aimed at commercially irrational arrangements that would not be entered into by third parties. Like the permanent establishment avoidance rule, it follows Australia in introducing such a rule.

It is worth bearing in mind that some transactions within a multinational group only arise by virtue of it being a multinational. This does not mean that the transactions are commercially irrational. KPMG in New Zealand has submitted that an exceptional circumstances condition for application of the re-characterisation rule should be included in the new rules if the intention is to only apply it to aggressive arrangements (as is supported by the OECD's position on re-characterisation). If not, this has the potential to drastically increase uncertainty for multinationals operating in New Zealand.

Another key change is to the onus of proof in transfer pricing matters, moving from Inland Revenue to taxpayers. This change is less surprising and has long been signalled by Inland Revenue as a likely change to the transfer pricing rules.

The new administrative rules to buttress Inland Revenue's access to information will allow the Commissioner to impute an uncooperative large MNE's tax liability based on information it holds. The justification is the asymmetry of information held by Inland Revenue versus the multinational (again, to encourage affected multinationals to comply). However, KPMG considers that in the current environment, information asymmetry cuts both ways, as Inland Revenue receives information from other tax authorities (e.g. under country-by-country reporting and other information exchanges). The Inland Revenue may also have comparable data the taxpayer does not on which it bases its assessment.

The proposal to shift the transfer pricing "statute bar" to seven years has been justified by Inland Revenue on the basis that transfer pricing issues can take longer to investigate (and other countries, notably Canada and Australia, having similar time frames). The aim of Inland Revenue's ongoing business transformation project, whereby Inland Revenue's systems and process are being redesigned for the 21st century, is faster, more certain action by Inland Revenue. Extending the statute bar period would seem to be contrary to Inland Revenue's business transformation goals.

2) New Zealand permanent establishment changes

The proposals centre around a rule to stop large multinationals (i.e. with global turnover greater than €750 million (\$836 million)) avoiding a New Zealand permanent establishment by using a New Zealand-related party to support local sales activities. The rule will apply:

- Where there are sales to New Zealand consumers or businesses by a non-resident supplier;
- A related entity in New Zealand (e.g. a subsidiary or dependent agent) carries out activities in New Zealand using local employees to bring about those sales;
- Some or all of the sales are not attributed to a New Zealand permanent establishment; and
- The arrangement is designed to defeat the intention of New Zealand's tax treaties.

This permanent establishment avoidance rule is broadly based on elements of the diverted profits tax in the UK and Australia's multinational anti-avoidance law. This is aimed at what the government considers are in country sales, rather than sales to consumers in New Zealand. However, it is worth noting that use of third party as well as related party sales channels can create a New Zealand permanent establishment under the proposals. Inland Revenue states that the aim is to change large foreign-owned multinational behaviour, rather than collect revenue.

Where sales are attributed to a New Zealand permanent establishment, transfer pricing concepts will be required to allocate the correct level of income and expenditure to this permanent establishment.

3) Interest deductibility and thin capitalisation changes

While the government is not proposing to replace the current thin capitalisation interest limitation rules (which are based on debt-to-assets), it is proposing a number of changes to strengthen these rules, including:

- Limiting the interest rate on related party debt to that based on the credit rating of the ultimate parent (plus a margin), i.e. an interest rate cap. The applicable margin proposed has been the equivalent of one credit rating notch below that of the ultimate parent. This cap is designed to anchor New Zealand interest deductions to a wider multinational's total cost of funds (i.e. that of the multinational group and not the credit rating of the New Zealand borrower).
- Requiring an adjustment to assets in the thin capitalisation calculation to require these to net-off against non-debt liabilities in the balance sheet other than interest-free loans (e.g. trade creditors and provisions).

The implementation of an interest rate cap would make New Zealand unique around the world. This has the potential to be a blunt instrument, for what will be widely varying circumstances across taxpayers. It assumes the New Zealand operations have the same assets, risks and functions as the



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parent (or rest of the group). To demonstrate otherwise, the New Zealand subsidiary (or group) will need its own public credit rating. The adoption of this rule has the potential to not only put New Zealand out of step with the majority of counter-party jurisdictions, it will also significantly limit interest deductions for New Zealand members of multinational groups and may lead to double tax.

The change to net rather than gross assets has the potential to shift the thin capitalisation “safe harbour” more significantly and much less predictably. Its effect will vary compared to the current 60% safe harbour depending on the role and size of non-debt liabilities. KPMG professionals expect this will push up thin capitalisation ratios, thereby increasing the incidence of interest deductions being denied for New Zealand members of multinational groups.

4) Implementing the multilateral instrument (MLI) in New Zealand

The government has signed the multilateral instrument on June 8 2017. This consultation paper confirms the broad shape of how the multilateral instrument will be implemented in New Zealand. New Zealand’s preferred approach is for comprehensive adoption of the substantive multilateral instrument BEPS provisions (including those that are not minimum standards for adopting the MLI). This compares with potentially more selective adoption of the multilateral instrument BEPS provisions by other countries. This may impact which of New Zealand’s double tax agreements will be covered agreements under the multilateral instrument.

Developments in relation to country-by-country reporting (including local file and master file)

Despite the dramatic shifts proposed above, Inland Revenue has remained steadfast to its position that no legislation is necessary to require country-by-country reporting for New Zealand members of multinationals in New Zealand.

Consistent with this, Inland Revenue has not, and at this stage has no intention of, legislating to require the adoption of the master and local file approach by New Zealand members of multinational groups. However, in practice Inland Revenue has specified on a number of occasions that it considers the master and local file approach to be the ‘norm’ for taxpayers.

Transfer pricing compliance activities by local tax administration and dispute resolution (including APAs)

While no specific increase in resourcing in the transfer pricing space has yet to occur, Inland Revenue now has access to a range of risk assessment tools to better identify and target transfer pricing matters. These now primarily include:

- A basic compliance package (BCP) issued to all New Zealand taxpayers with turnover greater than NZ\$30 million (\$21 million), requiring submission of financial information and group structure details; and
- An international questionnaire to foreign-owned taxpayer groups, which requests information in relation to the taxpayer’s financing/debt and transfer pricing.

These risk assessment tools have been supplemented with greater access to information from foreign tax authorities under wider information sharing powers.



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Jordan has supplemented his New Zealand experience by undertaking secondments to KPMG in the UK's London practice and KPMG in Indonesia, as well as spending time working at one of Australasia's largest banks.

As expected, this has led to the highest volume of Inland Revenue dispute activity seen to date. Not only is this in terms of the number of multinationals under audit, but also the duration and scope of these audits. KPMG professionals have observed a number of instances where Inland Revenue appears to be following on closely from the audit activity being undertaken by the Australian Tax Office (ATO). In particular, we have seen audit activity focus on foreign-

owned multinationals (as opposed to New Zealand-owned multinationals), with close attention on service-providers across the technology (and related) industries, where revenue generated from local New Zealand customers is being contracted for and recorded by an offshore entity within that multinational group (i.e. targeting perceived permanent establishment avoidance, or insufficient compensation for New Zealand value adding functions).

KPMG professionals have also seen a continued focus by Inland Revenue on cross border financing activity, where inbound loans exceed NZ\$10 million, with a number of long-term disputes involving multinationals currently in progress.

This increase in audit activity has inevitably led to an increased level of unilateral and bilateral advance pricing agreements (APAs), as taxpayers seek to minimise the risk and uncertainty associated with a prolonged New Zealand transfer pricing dispute.

The past 12 months have seen a significant shift in the transfer pricing landscape for multinational entities operating in New Zealand. The increasing incidence of lengthy transfer pricing disputes, driven by BEPS and the combination of more focused risk assessment, in conjunction with greater information sharing between overseas tax authorities, has led to a much greater need for multinationals to consider the unique aspects of New Zealand transfer pricing. Inland Revenue has further layered this uncertainty through its proposed transfer pricing and thin capitalisation rules. As a consequence, multinationals will need to carefully watch upcoming developments in New Zealand, and to ensure that their documentation and pricing models are sufficiently robust and detailed in order to navigate this increased complexity.

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Global requirements pushing compliance in the Philippines

By **Maria Carmela M. Peralta** of **KPMG** in the Philippines.

The Philippines still has a long way to go in transfer pricing. The much-delayed issuance of the transfer pricing regulations in January 2013 has not done much in creating a robust transfer pricing environment in the Philippines. The regulations do not have real teeth as there are no enforcement mechanisms in place. Even the Philippine tax office – the Bureau of Internal Revenue (BIR) – encounters challenges in implementing the regulations and releasing additional guidelines. One factor to explain this is that with many of its trained personnel having left, the BIR until now is still building capacity in transfer pricing. With this transfer pricing landscape, it is unlikely for the BIR to push in the near future for the adoption of the master file, CbC reporting, and local file requirements of the BEPS Action Plan.

Nevertheless, taxpayers should not disregard transfer pricing or the BEPS initiatives. There have been many cases of BIR teams conducting regular investigations (i.e., non-transfer pricing audits) asking for the documentation for the mere reason of it being required under the regulations. It turns out that the submission of the documentation is considered compliance already and stops any further questions on transfer pricing.

The documentation is also a ready defence for taxpayers that have restructured operations resulting to significantly lower revenues, thereby inviting the BIR's scrutiny.

As more and more countries adopt the BEPS initiatives on master file, CbC reporting, and local file requirements, subsidiaries/affiliates located in the Philippines will have to attend to the preparation of their documentation as part of their respective group's compliance. And with the CbC reporting starting to take effect for 2016, the increase in taxpayers within the past 12 months planning to prepare or having prepared their local file is notable.

On the other hand, as the number of Philippine conglomerates investing offshore increases, it is expected that these conglomerates will at a certain point in time be subject to the master file, CbC reporting, and local file requirements. Complying with these requirements will mean a lot of learning and work for these conglomerates, especially if they are imposed on the conglomerates by more than one foreign jurisdiction.

Challenges in the preparation of the local file for the group

Philippine subsidiaries/affiliates tasked by their headquarters to prepare the local file as part of their groups' compliance with BEPS have had a number of challenges. Good coordination will be required between them and their



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headquarters for the former to understand the importance of the exercise. In particular, this good coordination is needed to determine matters such as but not limited to the following:

- 1) Timelines that have been set at the headquarters' level for the preparation of the local file and the corresponding audited financial statements – While requirement under the Philippine transfer pricing regulations is that the documentation should be contemporaneous, this requirement is not being enforced by the BIR. The documentation is not required to be submitted to the BIR upon filing of the income tax return. There are no penalties imposed due to the mere absence of a contemporaneous documentation. In fact, the BIR personnel have informally stated that even during a BIR investigation, the taxpayer may just at that late stage prepare the documentation.
- 2) Presentation of sales and taxable income per business segment, per related parties vis-à-vis third parties, and per related party – Philippine financial reporting requirements do not extend to such detailed breakdown of the sales and costs/expenses. For example, operating expenses could be lumped together regardless of business segments and of the type of customers (whether related party or third party). The absence of readily available financial data could impact the computation of the profit level indicators for the related-party transactions. Losses may actually be with third-party transactions.
- 3) The point within the arm's-length range acceptable to the group (i.e., whether full range or interquartile range

and what percentile) – under the Philippine transfer pricing regulations, any point within the range is acceptable. However, this may not be the case for the headquarters.

- 4) Need for consistency with the groups' transfer pricing policy and/or description of its business operations.

Good coordination is critical especially for those Philippine subsidiaries/affiliates used to the BIR's lack of monitoring of compliance with transfer pricing regulations. It is an observation, too, that Philippine subsidiaries/affiliates understandably may have a good grasp only of the Philippine operations of the group. This could lead to gaps in the local file's content.

One area where caution is required is the narrative in the local file on the management structure of the Philippine entity. Issues could arise on the existence of a permanent establishment (PE) in the Philippines. While the BIR's current guidelines on PEs are not clear or extensive, this item should be considered carefully. Nevertheless, this item is not required by the Philippine transfer pricing regulations which essentially are based on the pre-BEPS OECD transfer pricing guidelines. But it has been observed that some headquarters do require this item to be included in the local file.

Another area of concern will be on non-interest bearing intercompany advances. In view of a Supreme Court decision, non-interest bearing advances may be acceptable. The Supreme Court has stated that since the payment of interest should be stipulated in writing as provided under the law, the BIR cannot impose a theoretical interest. This has caused issues in the discussions between related parties for proposed financing especially for the Philippine entity getting the advances and insisting that there should be no interest charged.

Challenges for Philippine conglomerates with offshore investments

For Philippine conglomerates with offshore investments and being subjected to the BEPS masterfile, CbC reporting, and local file requirements of foreign jurisdictions, there could be issues on how complying with these requirements (and with the arm's-length principle) will affect the revenues of group and of the headquarters. This is true especially for those Philippine conglomerates that have not yet pursued a coordinated approach in handling their transfer pricing concerns.

Even before such requirements get to be applicable to them, it may make sense for them to have a high-level transfer pricing risk assessment of their related-party transactions around the world. It is possible also that certain related-party arrangements are in place that they are unaware of and may have to account for in the future. Further, as these requirements include the submission of the corresponding contracts/agreements to the foreign tax office, they may have to check if these have already been executed.

The evolving transfer pricing landscape in Singapore

By **Geoffrey K. Soh**
and **Felicia Chia** of
KPMG in Singapore.

Tax landscape in Singapore

The transfer pricing landscape in Singapore has evolved over the past year, and for multinationals with local operations there is increasing scrutiny on the horizon. From broader requirements for tax transparency led by the Inland Revenue Authority of Singapore (IRAS), through more stringent transfer pricing guidelines and the contemporaneous transfer pricing documentation requirement to greater scrutiny of businesses via additional reporting of related party transactions as part of its tax compliance programme, every multinational with operations in Singapore is witnessing the impact.

New Singapore transfer pricing guidelines

On January 12 2017, IRAS released new transfer pricing guidance in the form of an e-tax guide – Transfer Pricing Guidelines 4th Edition (TPG4). In summary, TPG4 expands upon the guidance released by IRAS over the past two years. As with previous iterations, the content of TPG4 details transfer pricing concepts and methods, as well as how taxpayers should apply them. There are also sections on mutual agreement procedures (MAP) and advance pricing arrangements (APA), and the administrative details thereof.

Of importance, transfer pricing requirements such as the need for contemporaneous documentation to be completed by the taxpayer's filing due date remain unchanged. Compared to previous IRAS guidance however, most of the changes in TPG4 are focused in the following areas.

- Following last year's announcement that Singapore has joined the inclusive framework for implementing measures against base erosion and profit shifting (BEPS), TPG4 contains sections which are aligned to BEPS concepts. For example, in addition to endorsing the arm's length principle, IRAS subscribes to the principle that profits should be taxed where real economic activities generating the profits are performed and where value is created and will generally follow the OECD (Actions 8-10) 2015 final reports on aligning transfer pricing outcomes with value creation.
- The guidance detailing the treatment of risk has been significantly expanded. When analysing risks, taxpayers should:
 - a) Determine the risks assumed and the functions performed to manage that risk;
 - b) Demonstrate capacity to assume the risk and the capability to mitigate or control the risk; and



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Geoff has managed thousands of international transfer pricing engagements encompassing the compliance, planning, audit defence, and dispute resolution aspects of transfer pricing. He has helped clients in transactions relating to transfer of products, risks, services, intellectual property, and funds. In addition, he has led a number of advance pricing arrangements involving tax authorities from Asia, Europe, and the Americas.

Under his leadership, KPMG in Singapore was recognised by the *International Tax Review* as the Singapore Transfer Pricing Firm of Year 2016. His viewpoints and articles on transfer pricing issues can be found in industry publications and the media.

- c) Reflect the consequences of risk assumption and the remuneration for risk management into the transfer price.
- Contents of transfer pricing documentation have been expanded to include, where applicable, disclosure on the group's existing APAs and tax rulings, as well as the filing of a country-by-country report.
- Updates to the sections on MAP and APAs include:
 - a) Commentary on the spontaneous exchange of information on cross-border unilateral APAs, which IRAS will agree to if certain conditions are met;
 - b) Some flexibility on the bilateral or multilateral APA roll-back years beyond the usual two year rollback period;
 - c) Commentary that IRAS is unlikely to take a position that will be at odds with that determined by Singapore tribunals and courts; and
 - d) Clarifications on the deadlines involved during the APA filing process.
- As an alternative to performing detailed benchmarking, taxpayers may opt to apply an indicative margin for committed related-party loans from January 1 2017 that do

not exceed SGD 15 million (\$10.8 million). The indicative margin, which is published on IRAS's website and updated annually, is currently 250 basis points for the 2017 calendar year. The margin must be added to an appropriate base reference rate such as the Singapore interbank offered rate (SIBOR) or others.

Transfer pricing audits and reporting of related party transactions

On October 24 2016, IRAS released administrative guidance reflecting its increasing focus on transfer pricing audits. As set out herein, the IRAS guidance makes clear that taxpayers are expected to adopt arm's length pricing for their related party transactions (RPT). IRAS audits taxpayers' compliance with transfer pricing documentation and arm's length pricing requirements as part of its compliance programme.

IRAS will be introducing a new RPT reporting requirement for companies with effect from a financial year beginning on or after January 1 2017. The RPT reporting requirement will provide IRAS with relevant information to better assess companies' transfer pricing risks and to improve on the enforcement of the arm's length pricing requirement. Companies will be required to complete the form for reporting of related party transactions (RPT Form) only if the value of RPT exceeds SGD 15 million.

IRAS guidance states that the values of the following categories of RPT are to be reported in the RPT Form: sales and purchases of goods; services income and expense; royalty and licence fee income and expense; interest income and expense; other income and expense; and year-end balances of loans and non-trade amounts. In addition, in the case of a company with cross-border related party sales or purchases of goods and services, it has to list the top five foreign related parties that it transacts with (by value of sales or purchases respectively) and provide their entity details including entity names, countries, relationship and amounts transacted.

Country-by-country reporting

On October 10 2016, IRAS released its e-tax guide on country-by-country reporting (CbCR). In general, CbCR requires multinational enterprise (MNE) groups with a Singapore-based ultimate parent to compile information on the group's profits from operations worldwide. IRAS's position on CbCR follows Singapore's decision to participate in the OECD's inclusive framework, for the implementation of measures against BEPS.

The CbCR requirements set out by IRAS closely follow but are not identical to those proposed by the OECD under BEPS Action 13. CbCR will only be applicable to MNE groups, where:

- The MNE group's ultimate parent entity is in Singapore;

- The consolidated group revenue in the preceding financial year is at least SGD 1.125 billion (broadly equivalent to the OECD's €750 million threshold); and
- The MNE group has subsidiaries or operations in at least one foreign jurisdiction.

Where the Singapore entity is not the ultimate parent, it will not be required to prepare a CbC report. This is because the foreign ultimate parent may be responsible for filing the CbC report in its home country. However, the Singapore company may still be involved internally, by providing the required information to its ultimate parent.

In addition, a year later than many OECD countries, affected Singapore MNE groups will need to submit the CbC report within 12 months from the end of any financial year which begin on or after January 1 2017. To address the transition issue arising from this, affected Singapore-headquartered MNEs may file a CbC report for a financial year beginning on or after January 1 2016 to IRAS on a voluntary basis.

CbC reports submitted to IRAS will be provided to tax authorities of countries with which Singapore has signed bilateral agreements for automatic exchange of CbCR information. CbC reports may be used by Singapore and other tax authorities in evaluating transfer pricing risks and other BEPS related risks.

Tax transparency on the horizon

Since joining the inclusive framework, Singapore has been taking steps to keep pace with OECD requirements. IRAS is continuing to monitor taxpayer compliance, and appears to be increasingly taking enforcement action via tax audits. There may be upcoming changes in tax legislation and new penalties. In line with this new level of scrutiny, IRAS has recently mandated CbCR and a form for reporting related-party transactions, both of which are to be filed in 2018 by Singapore taxpayers meeting certain conditions and thresholds.

With TPG4, IRAS continues its trend of stressing transfer pricing compliance in line with BEPS concepts, in particular the need for robust transfer pricing documentation. Accordingly, companies with significant related party trans-



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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 and mutual agreement procedures. 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 and has published a number of articles in connection with transfer pricing issues. She was recognised as a leading adviser in Singapore in the inaugural 2015 and 2016 editions of the *International Tax Review's* "Women in Tax Leaders" guide.

actions will need to carefully evaluate the extent of their transfer pricing compliance in a systematic manner. Tax transparency is expected to increase in Singapore. While new initiatives emerge on the horizon, Singapore taxpayers are becoming more aware of the changes and many are updating their tax business models and transfer pricing policies.

Updates of Korean laws and practices regarding TP and relevant taxes including BEPS

By Kang Gil Won,
Baek Seung Mok
(William) and Sang
Hoon Kim of KPMG
in South Korea.

Recent years, topics related to BEPS have been actively brought about both in a global standpoint and that of South Korea. South Korean tax authorities (KNTS) have made significant efforts to strengthen the transfer pricing regulations and to consider the practical issues that the taxpayers would bear in the recent amendments of the legislations. The amendments aim to bring the Korean regulations more in line with the BEPS Project, as well as to address taxpayer concerns that were raised after the new filing requirements, and controversial issues related to payment guarantees. Topics discussed include the additional rules and penalty provisions relating to the master file, local file, and country-by-country (CbC) reporting requirements (collectively referred to as the combined report of international transactions or CRIT), deemed interest rate for intercompany loan transactions, controversies in payment guarantees, and the recent Korea-India tax treaty amendment.

This international tax review highlights major changes in the aforementioned tax revision.

1. CbCR requirements

Under the legislation amendment, the CbC report has been added to the scope of the CRIT. The CbC report is required for any multinational entity (MNE) with:

- 1) Sales revenue exceeding KRW 1 trillion (\$909 million) per consolidated financial statements for the preceding year, and would be required to be submitted by the ultimate parent company of the MNE. However, if the parent company is located in a foreign country that does not require a CbC report, or does not agree with the exchange of the CbC report, it would be the obligation of the domestic entity to submit the CbC report.

On December 28 2016, South Korea's Ministry of Strategy and Finance (MOSF) released a proposal of details with respect to CbC reporting. The proposal is known in English as proposed presidential enforcement decree of the law for the coordination of international tax affairs, or PED of LCITA.

The proposed enforcement decree would require that there be a reporting entity notification form filed concerning the CbC report. And that, multinational entities (MNEs) operating in Korea would be required to submit a reporting entity notification form in advance, specifying which entity would submit the CbC report to which

jurisdiction. While the final CbC report would be due within 12 months of the fiscal year-end, the reporting entity notification form would be required to be submitted within six months of the fiscal year-end (i.e., for the fiscal year ending December 31, the deadline would be June 30 of the following year) by MNEs operating in Korea. The filing is required to be submitted by:

- 1) Ultimate parent companies located in Korea (outbound) and,
- 2) Entities or branches located in Korea, which the parent companies reside in foreign countries (inbound).

2. Extensions of master file and local file

Under the previous proposals, the master file and local file was required to be submitted by the filing date of the corporate tax return. In the amendment, the required filing deadline for the fiscal year of 2016 would now be within 12 months of the fiscal year-end (i.e., for the fiscal year ending December 31 2016, the deadline is December 31 2017), providing MNEs additional time to prepare the master file and local file.

3. Local file exemptions

In consideration of the similarity of the advance pricing agreement (APA) application documents and the content of the local file, the amended regulation states to exempt some MNEs from preparing the local file. This exemption would apply for MNEs that have had relevant transactions covered by an already completed APA and considered to be at an arm's-length price. This exemption would not extend to MNEs that have submitted, but not finalised, an APA.

4. CRIT-related penalties

Previously the law stated that, if any part of the CRIT was not submitted or submitted and/or was falsely described, a penalty in the amount of KRW 30 million (\$27,000) would apply. Through the amendment, this penalty provision was revised so that each report would be subject to:

- 1) A separate penalty of KRW 10 million (\$9,000).

For example, if the MNE satisfied the threshold requirement for submitting the master file and local file, but only submitted the local file, the penalty would be KRW 10 million instead of KRW 30 million.

It is required that a detailed statement of cross-border transactions be filed, and the penalty for not submitting one or falsely providing any information in the statement has been KRW 10 million (approximately \$9,000). Through the amendment, this penalty provision was revised so that each statement missing for an entity would be subject to:

- 1) Separate penalty of KRW 5 million (\$4,500).



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Before joining KPMG, Gil Won led the outbound transfer pricing practice at Kim & Chang, Korea's largest law firm and helped establish its Chinese tax practice. He concluded the first Korean-Chinese APA and the first APA related to intra-group service transactions in Korea.

Gil Won was a member of the competent authority team of 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 appointed as one of the world's leading transfer pricing advisers in Euromoney's guide.

The penalty for both CRIT and a detailed statement of the cross-border transactions could not be more than KRW 100 million (approximately \$91,000) in total.

5. Controversies in payment guarantee fees

Until recent years, it has been the norm for the KNTS to impose taxes on Korean parent companies for providing payment guarantees to foreign subsidiary(ies) without receiving appropriate arms-length payment guarantee fees. However, there have been controversies with the credit assessment model used by the KNTS, a model developed by KNTS, on whether the model itself was an appropriate calculation methodology at arms length. In October 2015, the court decision interpreted that the methodology developed and used by KNTS was inappropriate for the following reasons:

- 1) Issues in availability of the data used
- 2) Issues in usage of domestic corporate bankruptcy rate
- 3) Disregard of industry-specific and non-financial information
- 4) Disregard of implied warranties
- 5) Disregard of locational factors

The court decision has diminished the controversies on the appropriate credit assessment to be used, and lessened the burden and confusion of the taxpayers in regards to the



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Seung Mok has been working in KPMG since 2002 and specialises in transfer pricing documentation/planning, tax audit defences, appeals, APA/MAP and designing and implementation of tax-optimised transfer pricing systems for multinational clients mostly investing in China, Vietnam, India, Mexico, EU and the US.

He is a member of South Korea CPA/CTA and takes care of KPMG key multinational clients including SK Hynix, Hanwha, Kolon etc. Recently he has held lots of seminars for Korean multinational companies on transfer pricing matters including BEPS action plans and has provided the clients with various TP services.



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Sang-Hoon is a transfer pricing partner. With over 20 years of work experience at the NTS, Sang-Hoon handled the MAP and APA approvals with various countries.

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.

matter. In the practical perspective, Moody's RiskCalc™ is now widely accepted for assessing credit-ratings used for calculating arms-length payment guarantee fees.

6. Interest rate for intercompany loan transactions

In respect to intercompany loan transactions the previous measure stated that the arm's-length interest rate for intercompany loan transactions is an interest rate applicable or deemed as applicable to ordinary monetary transactions between unrelated parties, taking the following matters into consideration: (1) the amount of the obligation; (2) maturity of the obligation; (3) whether the obligation is secured; and (4) the credit rating of the debtor.

Under the legislation amendment, the revised measure is to reflect that a deemed interest rate, as stipulated in the enforcement rules, could be applied by selecting either methods:

- 1) Arms-length interest rate that has been stated by MOSEF, or;
- 2) Arms-length interest rate that has been calculated.

As a result, a taxpayer could select either approach to apply an arm's-length interest rate, and this treatment would allow taxpayers to diversify the calculation methods available for an arm's-length interest rate.

This change has been effective for an intercompany loan transaction since February 7 2017, the date of enforcement.

7. Customs act amendment

Until recent years, taxpayers were not eligible for customs tax refunds for transactions that occur from compensating adjustments via overseas related parties. The previous customs act did not allow for custom tax refunds of the compensating adjustments, which were based on transfer pricing rule. However, the recent customs act amendment includes such compensating adjustment to be reflected to the transaction price of imported goods, leading to the availability of customs refund for the taxpayers if certain conditions under customs act are met. The requirements are listed as follows:

- 1) A taxpayer with approved APA, etc.
- 2) Compensating adjustments made pursuant to the arms-length method under LCITA
- 3) Submission of the preliminary price adjustment application form, before import of goods

The amendment will be in effect for goods imported from July 1 2017, the enforcement date. Filing for tax refunds can be made after approval of the submitted

preliminary price adjustment application form by Korea Customs Services.

8. Korea-India tax treaty amendment

It has been 30 years since the last effectuation of the Korea-India tax treaty in 1986, in which the new amendments are expected to provide solutions to the double taxation for companies operating in both countries, and further enhance economic cooperation between Korea-India. The subjects that have been newly implemented or amended are:

- 1) Introduction of mutual agreement procedure (MAP) regulation
- 2) Revision of taxable categories
- 3) Deduction in limited tax rate of dividends, interests, and fees
- 4) Granting partial right of taxation on capital gains to the source country
- 5) Increase in tax exemption of the source country's shipping income
- 6) Revision of permanent establishment (PE) definition

- 7) Revision of taxable basis in independent personal services
- 8) Exchange of financial information
- 9) Ineligibility for the application of the tax treaty for transactions with intention of tax avoidance

The new amendment in the Korea-India tax treaty has been made to pursue economic benefits on both countries. Although the intention of the amendment speaks for the betterment, it is nevertheless necessary for Korean companies that are currently or in plan to operate in India to strategise their corporate activities in a comprehensive manner, relative to the new amendment.

9. Korea government's LCITA reform proposals

Provided below are major topics for LCITA reform proposals currently under review by the MOSF:

- Hard- to-value-intangibles
- Low value-adding intra-group services
- Revision of PE definition
- High bride mismatching
- General anti-abuse rule etc.

Are you ready?

By **Shamila Jayasekara**
of **KPMG in Sri Lanka.**

Transfer pricing rules were introduced in Sri Lanka in 2006 and became enforceable from 2008. The revenue authorities did not administratively enforce rules, allowing tax payers more time to conform to requirements.

From the year of assessment 2015/16, it became mandatory for companies to submit an independent accountant's certificate and director's certificate to the revenue authorities, in relation to international transactions. The certificate broadly confirms compliance with regulations.

The regulations require the maintenance of specified documentation to justify the arm's length nature of international and domestic transactions between associated undertakings.

Changes to (or introduction of) local transfer pricing legislation (including regulations)

Currently transfer pricing regulations governing international transactions, do not apply to transactions between a permanent establishment in Sri Lanka and its head office. However the revenue authorities have intimated their intention to revise the regulations to cover same.

The revenue authorities have also intimated that the certification requirements would be extended to cover domestic transactions, where it leads to a loss of tax revenue. Hence it is likely that from 2018, transactions between domestic group companies where one of the entities derive exempt profits or the entity is liable to tax at concessionary rates or has a tax loss for claim, would be covered for transfer pricing certifications.

Release of new administrative guidance by local tax administration (e.g., tax rulings, practice statements)

Tax rulings are issued by the revenue authorities from time to time, providing administrative guidance on issues raised by tax payers. For example, presently there is no database of companies available in Sri Lanka to perform a comparability analysis. Therefore it was recently confirmed by the revenue authorities that tax payers are free to use a reliable database for this purpose.

These rulings are issued on a case-by-case basis and not made public. However, from 2018, Sri Lanka is to adopt a new tax code, in terms of which, the revenue authorities are required to make public all rulings.

The Institute of Chartered Accountants of Sri Lanka, is to issue a guideline recommending the work methodology that should be followed by independent accountants when issuing certification.

BEPS-related developments (other than CbCR – which is addressed below)

The government has not initiated a policy decision to implement BEPS action plans. With tax reforms in progress via the adoption of a new income tax law, it has been intimated that double tax treaties (DTT) would be revised. It is not clear at this stage whether the proposed revisions would entail implementation of BEPS action plans.

Developments in relation to country-by-country reporting (including local file and master file)

Since Sri Lanka is in its early stage of implementing transfer pricing, no steps so far have been taken by the revenue authorities to adopt CbCR requirements.

Transfer pricing compliance activities by local tax administration

The transfer pricing unit within the Inland Revenue Department was formed in 2015 and officers have been trained by the Indian Tax Authorities and the OECD.

2015 was also the first year in which certification relating to international transactions was submitted to the revenue authorities and it is anticipated that in the coming years, same would be subject to audit.

The regulations require that any TP audit on international transactions should be routed via a transfer pricing officer. Therefore tax officers in charge of corporate tax files, are required to refer any TP issues to the TP unit. Assessments relating to domestic transactions could be raised by tax officers handling the corporate tax files.

Dispute resolution (including APAs)

The local law provides for a company to enter into unilateral or bilateral APAs. However, no APAs have so far 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.

Litigation

According to the TP regulations, the revenue authorities could initiate a transfer pricing audit within five years from the end of the relevant year of assessment. Since enforcement of transfer pricing is new to Sri Lanka, the revenue authorities have not raised many assessments and are in the process of collating information. Certificates and disclosures



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Shamila counts experience in direct and indirect tax across a number of sectors and has been closely involved in advising on inbound investments into Sri Lanka.

Shamila set up and now leads the transfer pricing unit of KPMG in Sri Lanka. At present, KPMG in Sri Lanka is a market leader in transfer pricing and has 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. She has also been assisting the Institute of Chartered Accountants in preparing a framework for practitioners and has been an active speaker at public forums on the subject.

filed for the year of assessment 2015/16, may be used by the revenue authorities as a filter to identify TP issues, to initiate the audit process.

Since the TP regulations in Sri Lanka are very similar to the regulations in India, indications are that Sri Lankan authorities would rely on and be influenced by precedent case law in India.

Sri Lanka is in the early stages of enforcing transfer pricing provisions. It is expected that in the next two to three years, the revenue authorities would commence auditing international transactions and prescribed documentation. Hence it is advisable for MNEs to be compliant with local transfer pricing requirements.

New key tax developments on the progress in Taiwan

By Sherry Chang, Karl Chan and Anita Lin of KPMG in Taiwan.

The landscape of global tax is changing dynamically as the BEPS project is now entering its implementation phase, and more information reporting obligations are required to be followed in order to tackle tax evasion. Thus, the new global tax environment has triggered widespread pressure to reform tax enforcement in Taiwan. Taiwan's Minister of Finance (MOF) has been keeping up the pace to follow the global phenomenon of anti-tax avoidance. Consequently, there are a couple of key tax developments on the progress of giving statutory effect in Taiwan.

New VAT rules on foreign e-commerce

As the tax challenges of the digital economy evolve, Taiwan's tax system has been unable to collect a fair share of taxes from e-commerce transactions. When a foreign e-commerce enterprise, without establishing a fixed place of business in Taiwan, sells online services or intangibles to an individual customer in Taiwan, the individual customer would be required to compute and pay VAT to the tax authorities. However, due to the VAT collection mechanism and taxation compliance, the tax authority rarely collects such online service or intangibles transaction VAT from individuals. As a result, the tax authority is losing the tax base and Taiwan's e-commerce enterprises encounter unfair tax treatment.

In order to curb such tax evasion and present tax fairness, the MOF is adopting the recommendation from the OECD's BEPS Action 1, as well as referring the approach from EU members, Japan and Korea. Tax compliance obligation will be shifted to foreign e-commerce businesses located outside of Taiwan. Pursuant to the new VAT rules, foreign e-commerce businesses that meet the threshold requirements will be obliged to register with the tax authority and pay VAT in Taiwan.

New amendments on exchange of tax-related information

For the purpose of tax transparency, the OECD is adopting the global recommendations of the automatic exchange of information (AEOI). In addition, the OECD's multilateral competent authority agreement (MCAA) for the common reporting standard (CRS) is also widely implanted by more than 100 jurisdictions while the OECD determined that these implementations are objective criteria to be used to label countries as non-cooperative for transparency purposes. Due to its political status, Taiwan is unable to participate in the exchange of



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Sherry has extensive experience in providing general tax advisory services to multinational enterprises; particularly, she specialises in assisting multinational enterprises in resolving tax (including transfer pricing) disputes with the Taiwan tax authority. Her areas of industrial specialisation cover electronics, petrochemicals, construction, telecommunication, automotive, media, consumption products, and financial services, etc.

Sherry holds a bachelor's degree in accounting from the National Chung-Hsing University (now known as National Taipei University). She is an accredited member of the Association of Certified Public Accountants in Taiwan and a frequent speaker for industry conferences on various tax topics.



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Karl's client portfolio covers multinational enterprises involved in electronics, petrochemicals, construction, telecommunication, automotive, marine transportation, apparel, and cosmetics, etc.

He has also participated as a speaker for transfer pricing seminars, Taiwan tax authorities, and various foreign trade organisations.

information mechanism so that the MOF amended the Article 5-1 of Tax Collection Law to accommodate exchange tax-related information in order to enhance tax transparency and also prevent from being labeled as a non-cooperative jurisdiction. New amendments include reciprocal information exchange agreements with other jurisdictions and scope of the information exchanged.

New anti-tax avoidance enforcement:

Taiwan's tax authority has been consistently moving toward combatting tax avoidance. In 2016, the revelations of the Panama Papers and the global trends of anti-tax avoidance stimulated actions to legislate two significant anti-tax avoidance instruments, controlled foreign company (CFC) rules and place of effective management (PEM) that specifically tackle the use of tax havens to avoid paying taxes. However, in order to alleviate the impact on Taiwanese companies, the MOF specified that the date of implementation of CFC and PEM rules will be conditional on 1) the effective date of a tax agreement between Taiwan and China 2) implantation status of international CRS 3) the enforcement rules of CFC and PEM are finalised and circulated in public.

CFC rules

Under current tax rules, there is the option to defer taxation as long as the overseas subsidiaries of Taiwanese companies do not repatriate earnings back to Taiwan. Therefore, some Taiwanese companies retain their overseas profit in offshore, especially through investment structure, most overseas profits are parking in low-tax jurisdictions. It raised significant tax base erosion due to the loophole under current tax rules in Taiwan.

With the effort to tackle tax avoidance, MOF is adopting recommendations from BEPS Action 3 and other jurisdictions' practices to stipulate CFC rules. According to new CFC rules passed in Taiwan's legislation, Taiwanese companies shall include their pro-rated share of those CFCs' profit as investment income in their taxable income. Once the overseas subsidiaries meet both of the following conditions, the subsidiary will be defined as a CFC under the new regulations:

- more than 50% of the foreign company's capital directly or indirectly is owned by Taiwanese company
- foreign company situated in a low-tax jurisdiction, the low-tax jurisdictions include those where the corporate income tax rate is lower than 11.9% or tax only imposed on domestic-source income under territorial tax system



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Anita has a wide range of transfer pricing experience, having been involved in advising transfer pricing planning, preparing contemporaneous documentation and assisting in tax audits for multinational corporations operating in information, communication and financial service. In addition, Anita was seconded to KPMG in Singapore's transfer pricing practice and engaged in a variety of international transfer pricing projects.

Anita is a US certified public accountant, and holds an MSc degree in international business and management from the UK and a BA in accounting administration from Taiwan.

The implementation of CFC rules is expected to prevent long-term deferral of taxation from Taiwan tax perspective. However, with reducing administrative and compliance burdens, the CFC rules are introducing *de minimis* thresholds and substance exemption. Meanwhile, prevention and elimination of double taxation are also designed in the new CFC rules.

PEM rules

When determining the residential status of a company in Taiwan, it depends on whether the company is incorporated in Taiwan. Once the company is incorporated in Taiwan is subject to taxation on their worldwide income pursuant of Article 3 of the Income Tax Act (ITA). Consequently, business enterprise manipulated the tax system to establish their business outside of Taiwan while executed operation in Taiwan in order to avoid taxation. To combat tax abuse, the MOF promulgated the PEM rules that if a company's place of effective management is Taiwan, it will be treated as a Taiwan resident company and its global income will be taxable as well as there are compulsory obligations to fulfill all tax compliance in Taiwan. Under the new PEM rules, once a business meets all of following criteria, a business enterprise regards the place of effective management in Taiwan, it will be treated as Taiwan resident company:

- The person who executes major decision for significant operation, accounting and finance, or human resources resides in Taiwan, or the headquarters of the foreign company is situated in Taiwan, or major business decisions are made in Taiwan, and
- Accounting books and records, or the shareholder or board meeting minutes are prepared or stored in Taiwan, and
- Major business activities are operating in Taiwan.

Transfer pricing practice in Taiwan:

The latest status of implementation for BEPS Action 13

In respect of the implementation and application of BEPS Action 13, the MOF has indicated that it will amend domestic transfer pricing regulations in order to reflect BEPS Action 13 guidelines, especially including country-by-country reporting and master file. From the Taiwanese tax perspective, it is anticipated that the content of CbCR and master file will align with the OECD requirements. The timeframe for implementing CbCR and master file is to be announced later this year.

Key issues of transfer pricing audit

The tax authorities have been speeding up transfer pricing audits, particularly focusing on companies from different industries or foreign-owned companies in Taiwan. Regarding transfer pricing audits, the Taiwan tax authorities continually pay attention to whether there are any inappropriate approaches for applying transaction-by-transaction bases or selecting profit-level indicators when using the transactional profits method. Meanwhile, the tax authority is exploring the possibility of utilising the profit split method under value chain analysis while the transactional profits method is currently the most favourable method to be selected. In addition, the following issues will be a focused for tax authorities when TP audits come into place:

- Transfer of tangible assets: business enterprise's profit are volatile or deficit over the years when the sales or cost involved enormous controlled transactions;
- Transfer/use of intangible assets: business enterprises provide know-how and trademark to foreign subsidiaries without any consideration in return, or foreign-owned companies in Taiwan reimburse significant payment for using intangible assets to its overseas headquarters;
- Rendering of services: business enterprises provide technical support to overseas affiliates without charging proper compensation; and
- Use of funds: parent companies are exposed to financial risk when providing foreign subsidiaries guarantees for loans while parent companies do not charge guarantee fees.

Thailand introduces transfer pricing legislation

By Benjamas Kullakattimas and Abhisit Pinmaneekul of KPMG in Thailand.

In light of recent global transfer pricing trends, the tax authorities in various jurisdictions are clamping down on multinational companies stripping out profits and not applying sound transfer pricing policies. As a result, there has been a change in the transfer policies as well as the pricing arrangements of many companies operating in Thailand including foreign investors. The impact of such changes has predominantly given rise to a decrease in Thai profitability. To ensure Thailand does not fall short and collects its fair share of revenue allocation, the Thai government has been increasingly focused on transfer pricing, and there has been significant progress in the transfer pricing legislation in Thailand for the past few years.

Introduction of local transfer pricing legislation

The draft transfer pricing legislation was approved by the cabinet of Thailand in May 2015 and by the National Council of State (Krisdika) in late 2016. According to the new Thai constitution, which was introduced in April 2017, a public hearing on the draft legislation is required before such legislation can be passed to parliament for enactment. It is expected that the public hearing on the draft transfer pricing legislation will be conducted within the third quarter of 2017, in which case, the new transfer pricing legislation may become effective for the accounting year ended on or after January 1 2018.

It is understood that the new transfer pricing legislation will be incorporated under the corporate income tax section of the Thailand Revenue Code and will cover the following three main provisions:

- **Power of the tax authority:** The tax authority will be granted the power to adjust the assessable income and allowable deductions of an entity that entered into a transaction with another related entity under different commercial and financial conditions from a transaction between independent parties;
- **Time limit for a tax refund request:** An entity that has overpaid tax or has excess withholding tax as a result of a transfer pricing adjustment can request a tax refund within 60 days from the date of receiving an assessment. The purpose of this provision is to reduce the occurrence of double tax which may arise where, for example, the assessment is issued after the expiry of period in which a taxpayer can request a refund request (i.e. three years following the filing deadline of the tax return).
- **Documentation and filing requirement:** The new legislation will require a taxpayer with related party transactions to prepare compulsory



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transfer pricing documentation which must be submitted to the Thai Revenue Department (TRD) within 150 days after the end of an accounting period (which is the same date that a taxpayer is required to submit and file its annual corporate income tax return). Failing to prepare and/or submit this documentation could lead to penalties of up to THB 400,000 (\$11,000).

Are taxpayers required to submit full transfer pricing documentation?

The expectation (in line with the procedures followed in various other countries) is that at the time of the submission of the corporate income tax return, the TRD may only require the taxpayer to submit a "form" as part of its income tax return filing which discloses the related party transactions and potentially introduce a "yes/no" question on whether the taxpayer has prepared the full transfer pricing documentation as required under the Thai Revenue Code. The TRD may then use the information in the form and the answer provided to the yes/no question to request the taxpayer to provide all the transfer pricing documentation for the TRD's review. The form and yes/no question will also enable the TRD to assess the compliance status of the taxpayer providing the TRD with the means to impose the penalty of up to THB 400,000 if necessary. At the time of submission of the taxpayer's corporate income tax return it is important that the taxpayer has prepared and is in a

position to submit, if required, the full transfer pricing documentation to the TRD.

Is there a threshold value for related party transactions?

The draft transfer pricing legislation does not currently provide a threshold value for related party transactions. However, KPMG professionals understand that not all taxpayers will be required to prepare the transfer pricing documentation. Therefore, it is likely that the TRD may provide a threshold value for related party transactions in future.

BEPS-related developments

Thailand has given clear indications to the OECD members that it is willing to participate and co-operate in the various OECD initiatives and working groups. The Thai government announced on May 16 2017 that it will join the OECD's BEPS inclusive framework as an associate country. In the announcement it stated that Thailand would like to establish clearer standards to protect against international tax invasion and to utilise the exchange of the country-by-country (CbC) reports. KPMG professionals speculate that CbCR may be enforced in Thailand after the main transfer pricing regulations are enacted.

Below are some other notable tax developments in Thailand:

Digital economy

The digital economy provides increased opportunities for e-commerce operators to reap substantial sales from a country without establishing a taxable presence in the said country. The existing permanent establishment (PE) rules in domestic tax law and tax treaties require some type of physical presence before a PE can be established in another country. Under Section 76 bis of TRC, a foreign company is deemed to carry on business in Thailand and will be subject to Thai tax if it derives income in or from Thailand through the activities of its employee, agent, representative or go-between in Thailand. Based on a strict reading of these provisions, if a foreign operator which carries on an e-commerce business does not enter Thailand or does not have any employee, agent or representative and/or server located in Thailand, such foreign operator should not be regarded as carrying on business in Thailand and thus shall not be subject to income tax in Thailand. The TRD is aware of this loophole and it is expected that the TRD will soon introduce new law to capture the taxation of cross-border e-commerce transactions in Thailand. If the foreign operator has some type of presence in Thailand, such foreign operator may be considered as conducting business in Thailand and resulting in a liability to pay Thai tax. Thus, it is possible that the focus of the TRD is to broaden the interpretation of what constitutes a taxable presence or PE in order to include cross-border e-commerce transactions in the Thai

tax system. How this will impact on the application of double tax treaties is also a relevant point. Generally, if a PE is created in Thailand, the foreign operator would be taxed in Thailand in the same manner as a Thai operator.

Anti-tax avoidance

In 2017, amendments were introduced in the Thai Revenue Code which provides that (1) tax evasion or tax from fraudulent activities amounting to THB 30 million per year or (2) a tax refund resulting from faulty facts or from fraudulent or similar activities in nature amounting to THB 2 million per year may be subject to the penalties and sanctions processed under the Anti-Money Laundering Act.

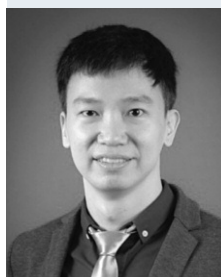
Transfer pricing compliance activities by the local tax administration

KPMG professionals have seen trends in the following areas:

- The general tax audit teams of the TRD have started to conduct transfer pricing audits in addition or subsequent to the completion of their corporate income tax audits. We also understand that the transfer pricing audit team has been promoted to focus on the Advance Pricing Agreement and to guide the general audit teams in their transfer pricing audits.
- Increasing tax investigations on the provision of intercompany services. Tax officers are requesting taxpayers to provide supporting documentation to prove the benefits received by the service recipients and the details of the pricing policy adopted (i.e. components of the cost base and the mark-up and allocation key applied).
- In the context of a business restructuring, taxpayers need to be more cautious on whether there could be a potential exit charge or creation of a permanent establishment in Thailand which may be challenged by the TRD.
- In the past, the TRD focused on cross-border intercompany transactions, however, we have seen recent cases where the TRD has audited domestic intercompany transactions which could result in not only additional corporate income tax liabilities, but also in additional value added tax and/or withholding tax liabilities.

Dispute resolution (including advance pricing agreements)

There has been increased activity in the conclusion of bilateral advance pricing agreements with the TRD attending negotiation meetings with overseas tax authorities more



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He has led and conducted a number of local/global transfer pricing planning and documentation engagements and reviewed various transfer pricing systems, cost structuring arrangements, global business models and supply chains. He has also advised on the restructuring thereof where required. His experience includes assisting clients in customs, tax and transfer pricing audits as well as negotiating with tax authorities and leading the conclusion of bilateral advanced pricing agreements. Abhisit has been a speaker for various transfer pricing seminars. He was also engaged in the technical sharing session of the OECD transfer pricing guidelines and BEPS with the tax authorities. He has been a lecturer of a tax planning course in Chulalongkorn University.

often. The TRD appears, however, to be adopting a more strict approach in the application of bilateral advance pricing agreements where profits and tax are being reduced in Thailand without substance. In addition, during the advance pricing agreement process, the TRD may question other tax-related implications, such as the exit charge, the creation of PEs, withholding tax, etc. As a result, it is prudent that taxpayers review not only the transfer pricing aspects but all other tax related matters applicable to their structure before applying the provisions of the Advance Pricing Agreement.

Before the transfer pricing regulations are enforced in Thailand, taxpayers with related-party transactions should start preparing the required transfer pricing documentation (including a local benchmarking study) to evaluate the transfer pricing risks inherent in their business and to identify any corrective actions or steps which should be taken to manage those risks in advance.

Make or break, first APA concluded

By Hoang Thuy Duong, Huynh Nhan and Tran Thi Thuy Ha of KPMG in Vietnam.

Alongside the worldwide trend of international tax reforms resulting from the OECD's recommendations in the BEPS Action plan, Vietnam has re-written its transfer pricing regulations. A government decree (No. 20/2017/ND-CP) dated February 24 2017 regarding the administration of transfer pricing matters, sets the foundation for post-BEPS regulations in the country. The Ministry of Finance's Circular No. 41/2017/TT-BTC dated April 28 2017 provides guidance on some articles of Decree 20.

Decree No. 20/2017/ND-CP and Circular 41/2017/TT-BTC – The new transfer pricing regulations, with effect after May 1 2017 is considered a major watershed for the transfer pricing state of affairs in Vietnam, providing absolute clarity of contemporaneous documentation requirements, together with the introduction of transfer pricing directives and guidance that mirror some of the key BEPS recommendations. With these actions, the Vietnamese government aims to prevent the potential loss of tax revenue and tackle abusive transfer pricing practices.

More than ever, foreign and Vietnamese multinationals should be much more diligent about their transfer pricing arrangements, by taking relevant actions to ensure consistency with mandatory filing requirements from the parent company in accordance with BEPS regulations of their country of residence and in connection with the trade agreements signed with Vietnam.

For many multinationals, this will be a significant and fundamental change from their historical transfer pricing practices and they should be prepared to extend documentation compliance efforts to review their transfer pricing policies and strategy and prepare proactive defence plans to navigate the contemporary tax framework in Vietnam.

As the decree is coming into effect, the expectation is for the Vietnamese Tax Department to enhance its capacity building accordingly and maintain interaction with relevant international organisations to enforce the decree in an efficient manner, especially in instances where income may go untaxed when dealing with foreign related parties, but should also enable businesses investing in Vietnam under non-harmful tax practices to ease the administrative burden to operate in the country.

Vietnam has established a steering committee, led by the director general of the General Department of Taxation, with a mandate to work on all BEPS actions beyond transfer pricing.

Specific developments in relation to BEPS Action 13

The new transfer pricing regulations under Decree 20 align with recommendations from the OECD's BEPS Action 13, including documentation requirements for a transfer pricing package consisting of:

- i) A master file containing standardised information relevant for all multinational enterprises (MNE) group members;
- ii) A local file referring specifically to related party transactions of the local taxpayer; and
- iii) A country-by-country reporting (CbCR) related to the MNE's income and taxes paid together with certain indicators of the location of economic activity within the MNE group. This reporting is required in the following cases:
 - a) Taxpayer is the ultimate parent company of a group in Vietnam which has global consolidated revenue in the tax period exceeding VND18,000 billion (€750 million, \$836 million); and
 - b) Where overseas ultimate parent company is required to submit a CbCR to a foreign tax authority in their respective jurisdiction, the Vietnamese taxpayer is required to submit a copy of such CbCR. Failure to do so, Vietnamese taxpayer requires to submit written explanation to the local tax authority.

Decree 20 and Circular 41 provide details and guidance for mandatory disclosure forms of related party transactions (i.e. Form 01); and the content and documents required in the local file (i.e. Form 02), master file (i.e. Form 03), and CbCR (i.e. Form 04). Forms 02 to 04 mirror the requirements under BEPS Action 13 with minor departures.

Changes to local transfer pricing legislation

The new transfer pricing regulations consider key elements provided in BEPS Actions 8 to 10, including a 'substance over form' standard; measures for the comparability of related-party transactions against independent transactions; consideration of development, enhancement, maintenance, protection and exploitation (DEMPE) functions with respect to intangibles; and guidance on tax deduction for intra-group service expenses.

With the introduction of the 'substance over form' principles, the new regulations aim to modernise the transfer pricing regime beyond the review of contractual arrangements to the analysis of business substance linked to value creation. Vietnam-based subsidiaries, as part of multinational groups will be required to revise their current transfer pricing policies with coherent, consistent and more evident alignment of substance and value creation to distinguish the entrepreneurial role of parent or holding companies, together with a solid connection with intangible ownership, risks assumed and controlled, and higher transparency to address the relevant transactions for the local file.

Similarly, an increased level of scrutiny is expected for local subsidiaries performing royalty payments related to the



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Duong has advised multinationals on tax, customs and transfer pricing planning, compliance and dispute resolution, supply chain tax planning and business restructuring. He has provided tax due diligence and structuring advice for corporate transactions in various sectors, including industrials, automotive, FMCGs, financial services, infrastructure, IT, and the Japanese market.

Duong was the engagement partner of several dozens of transfer pricing audit and dispute resolution engagements, and many of these cases were resolved successfully either in the audit, appealation or in one court case (the only court case on TP adjustment in Vietnam so far). Duong was invited to speak to the central and provincial fiscal and non-fiscal authorities on international best practice of transfer pricing audits and local practical issues. Having been the engagement partner for a transfer pricing capacity building project with the General Department of Taxation (GDT), Duong advised on the conclusion of Vietnam's first advance pricing agreement (APA), which is the only APA concluded so far. Duong has provided advice to the General Department of Taxation and Ministry of Finance in relation to the Decree 20/2017/ND-CP on transfer pricing management in line with BEPS Action 13, including the consideration of practical issues in local transfer pricing audits of multinational corporations operating in Vietnam.

use of intangibles which may not be appropriate related to intermediate or semi-finished goods, and those subsidiaries with payments for management and administrative services that may lack of proper support to demonstrate the benefit received by the local entity and the methodology to calculate the fee. These transactions may be considered as harmful tax practices by the General Department of Taxation in Vietnam.

However, it is expected that tax authorities may consider contractual arrangements before reviewing the actual transactions based on business facts and substance, in order to reduce the burden of proof for taxpayers. The application of



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Nhan has extensive hands-on experience in representing clients and dealing with local authorities on customs and taxation issues.

He has been invited to speak at forums and seminars on Vietnam's inbound investment, customs and taxation.

Nhan holds his bachelors from the University of Melbourne, Australia.

Nhan speaks, reads, and writes English and Vietnamese fluently.

- i) Taxpayer having annual revenue which does not exceed VND50 billion (\$2.27 million) and the total value of related-party transactions does not exceed VND30 billion (\$1.36 million); or
- ii) Taxpayer has concluded an APA; or
- iii) Taxpayer who performs routine functions and does not generate revenue or incur expense from exploitation and use of intangibles, has annual revenue not exceeding VND200 billion and a ratio of net operating profit before interest and CIT to net sales revenue (i.e. operating margin) exceeding 5% for distributors; 10% for manufacturers; and 15% for toll manufacturers.

Hierarchy regarding the use of comparable transactions or companies

The priority order in selection of comparables transactions or companies is provided under Decree 20 (with further guidance under Circular 41), with requirements on the analysis of quantitative and qualitative comparability and material differences when selecting foreign comparable in other geographic regions. Specifically, the hierarchy order which should be followed by taxpayers is stipulated as follows:

- i) Internal comparables of the taxpayers (e.g. comparable uncontrolled transactions);
- ii) Comparables located in the same country, territory of the taxpayer (i.e. Vietnam); and
- iii) Comparables located in the region which have similar industry condition and economic development level (e.g. South East Asia or developing countries).

The taxpayer is expected to elaborate in detail on the efforts performed to follow the above mentioned hierarchy when preparing the transfer pricing documentation package.

Use of secret comparables for risk assessment purposes

The use of secret comparables is considered to be primarily for tax risk assessments by the tax authority only, with the consideration for the use of commercial databases and public information to prevail in case of a proposed tax assessment during a transfer pricing audit. However, the current text of the decree is not crystal clear in this regard, saying that the tax authority may use different sources of information, including commercial databases and publicly available data, including their own database and information provided by some ministerial bodies for the purposes of transfer pricing risk assessment and tax adjustment. However, in transfer pricing audit cases where taxpayers fail to submit the required disclosure forms or transfer pricing documentation package within the statutory timeline, the tax authorities will have absolute power to assess the price and/or profits of the taxpayers based on their secret comparables.

such principles will enable the tax authorities to disregard or re-characterise related-party transactions in instances when those result in reduced tax revenue.

Timeline for preparation and submission of TP documentation package

The contemporaneous documentation requirement is clearer and stricter as the decree states that documentation package must be prepared before the annual corporate income tax (CIT) finalisation deadline (i.e. 90 days after fiscal year-end under Vietnam's laws).

In the event of a tax audit, the TP documentation package is required to be submitted within 15 working days from receiving formal request to provide information. If an acceptable reason is provided, the submission deadline may be extended by the tax authority only once with an additional 15 working days upon the former expiry date.

Exemption thresholds

Certain thresholds are also provided for exemption from documentation rules (but submissions of Form 01 is still required) in the following cases:

Year-end transfer pricing adjustments

Decree 20 and Circular 41 outline the use of year-end adjustment resulting from transfer pricing that increase the taxable income of the local taxpayer (i.e. upward adjustment). However, restrictions may apply to disregard downward adjustments resulting in lower taxable income for the local entity at year end, unless an advance pricing agreement (APA) is in place.

This approach may not reconcile with current practices in other countries, and therefore it should be analysed with high care by local taxpayers in conjunction with their parent company. Furthermore, Circular 41 remarks that non-adjustment leading to the shortfall of tax amount is deemed to violate the transfer pricing regulations and subject to the tax assessment.

Limit on interest deduction

A tax deduction limitation for interest expenses is also introduced in Decree 20 in consideration of BEPS Action 4, with a fixed ratio rule that caps the interest deduction to 20% of earnings before interest, taxes, depreciation and amortization (EBITDA).

Dispute resolution (including APAs)

Advance pricing agreements

APAs are available in unilateral, bilateral or multilateral forms under Circular 201/2013/TT-BTC dated December 20 2013 of the Ministry of Finance. There are now more than 10 APAs under different stages of the process, including pre-filing, evaluation, and negotiation. KPMG in Vietnam advised a client to have concluded Vietnam's first APA which is the only one ever concluded in the country.

Transfer pricing administrative appeals, judicial procedures and mutual agreement procedures (MAPs)

Technically all of these alternative dispute resolution options are available under Vietnam's laws and double tax treaties in effect. In practice, the appeal process is often lengthy with mixed results, judicial unpopular processes and MAPs not very productive.

The common effective options are to be compliant and defensive in an audit that requires taxpayers to be responsive to and cooperative with the tax authorities.

Litigation developments

Litigation actions towards tax authorities before the court continue to be rare in Vietnam. The vast majority of audits that resulted in transfer pricing reassessments were resolved at the tax department level, however, the year 2016 marked a precedent for the first litigation case on transfer pricing that was brought to Vietnam's court with the Provincial Tax Department as the defendant.

This litigation case was ultimately resolved in favour of the taxpayer, as the judge recommended the tax authority to



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Ha is directly involved in consultation with the General Department of Taxation and Ministry of Finance in relation to the Decree 20/2017/ND-CP on transfer pricing, including the consideration of practical issues in local transfer pricing audits of multinational corporations operating in Vietnam.

enter into reconciliations. During the reconciliation process, the tax authority agreed to withdraw the transfer pricing assessment decision and recalculate the tax liability using an independent benchmarking report, in which KPMG Vietnam directly assisted the taxpayer and acted as a litigation advisor, thereby defeating the tax authority's use of secret comparables on legal basis.

The final settlement at court not only alleviated financial liabilities for the taxpayer, but more importantly set good precedence on use of commercial database in transfer pricing audits.

Time for readiness in Vietnam

The unveiling of Decree 20 is expected to result in higher level of transparency between taxpayers and tax authorities

beyond the boundaries of Vietnam, given that for the first time tax authorities will have, via the master file and CbCR, a clearer view of where value is created, and in which tax jurisdictions multinationals make profits and pay taxes.

Navigating the proliferation of BEPS-driven requirements will require careful risk based approach to reduce the likelihood of challenges, limit potential double taxation, and

align tax goals with business objectives, particularly since new rules always raise interpretation issues.

Taxpayers should consider conducting a comprehensive risk assessment and readiness analysis for the regulatory change to understand their particular impact, and adherences or differences of their current transfer pricing policies with the new regulations and ensure full compliance in Vietnam.



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