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INTERNATIONAL TAX REVIEW™

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Asia Transfer Pricing

INTERNATIONAL TAX REVIEW™

Unless otherwise stated, all information in this report is based on the tax regulations for the countries reviewed on or before July 16 2018 or from KPMG professionals' experience working with tax clients and tax clients and tax authorities in their local countries.

INTERNATIONAL TAX REVIEW

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Reaching the tipping point

The OECD's BEPS initiative has sparked a global focus on MNEs and their transfer pricing. In recent years, writes Tony Gorgas of **KPMG Australia**, there has been a profound change in the ASPAC region as governments and tax administrations seek to ensure multinationals pay their fair share of tax in line with economic and value creation.

Unsurprisingly, the acceptance and implementation of country-by-country (CbC) reporting (CbCR) within the region has been relatively swift, with many MNEs headquartered in ASPAC countries already having completed their first round of CbCR for the 2016 financial year. In addition, some countries have also imposed severe penalty regimes where multinational enterprises (MNEs) fail to lodge CbC reports to 'encourage' taxpayers to behave in a manner which is first and foremost about transparency. The country updates in this year's survey address the key developments regarding CbCR in their jurisdiction. However, a more challenging consideration for MNEs who have already lodged their CbC reports will be how to best prepare for any potential tax authority compliance activity following the review and assessment of the information collected under CbCR. In our experience, MNEs' efforts can be guided by performing a value chain analysis to identify whether there are any mismatches between where economic value-added activities are being performed and where the profits are being returned. Ensuring these risk areas have robust transfer pricing (TP) analyses will be paramount, as tax administrations would undoubtedly flag these types of misalignments for further review.

Given that tax administrations are now equipped with the data from CbCR to review and assess arrangements within the context of the global value chain, the message is clear that MNEs should prepare for their arrangements to face scrutiny above and beyond what has historically been the norm. This past year we have already seen an increase in TP compliance activity, coupled with an unprecedented level of media attention. As the scrutiny on TP continues to grow, it is important that MNEs be prepared and mindful of the implications of business decisions on their overall TP. For example, an upcoming change that we expect will garner a lot of attention from MNEs and tax administrations alike is the US tax reform. Many businesses will be preparing to react to the new opportunities being presented, but any business restructures in light of this reform will need to be thoroughly substantiated and evidenced to be consistent with arm's-length principles through contemporaneous TP analysis and documentation.

In addition to the above, the past year has also seen important developments in a number of ASPAC countries in relation to their TP rules. Countries such as New Zealand and Singapore have either updated or are in the process or updating their TP rules. A key feature of this updating tends to be a focus on the broader commerciality of arrangements

entered into between members of MNE groups and whether independent parties would have entered into such arrangements. Given these tax administrations are now armed with formal powers to effectively reconstruct arrangements, MNEs with operations in these jurisdictions will need to ensure that they are sufficiently prepared to both explain and support their operations in these jurisdictions. This is also important given unilateral reconstruction could lead to double taxation outcomes which could lead to unresolved double taxation which may not be able to be relieved by the mutual agreement procedure. The question of whether we will continue to see more countries enacting broader powers to tax administrations across the ASPAC region is yet to be determined.

Taking into account the above, it is clear is that we have well and truly reached the tipping point, with all eyes focused on MNEs doing the right thing. By sharing our insights into the TP developments in the ASPAC region, we hope you will be able to better understand this new TP landscape.

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Tony is well experienced in negotiating favourable outcomes for clients, and has successfully concluded advanced pricing arrangements with key jurisdictions including the US, UK, Japan and Korea. He also has valuable experience in the resolution of mutual agreement proceedings between competent authorities. Tony assists clients across all industries in setting and reviewing global TP policies, ensuring optimal tax outcomes and successfully defending such policies with revenue authorities.

US corporate tax reforms – impact on the Asia Pacific region

Tony Gorgas, Jay Mankad, Jennifer Goldkopf, Cheng Chi, Yosuke Suzaki, Jee-Won Shin, Shamila Jayasekara, and Anita Lin of **KPMG** review the changes in US tax legislation and discuss their specific impact on jurisdictions around the Asia-Pacific region.

When the US president signed the Tax Cuts and Job Act (TCJA) (PL 115-97) into law on December 22 2017 it represented the most substantial overhaul of the US tax code since 1986 (US tax reform). This legislation was the result of a lengthy pursuit of business tax reform and, among other things, included several provisions targeting cross-border transactions. These changes will require multinational enterprises (MNEs) to actively consider and manage several business decisions such as location of people and assets, supply chain management, existing contractual arrangements, financing, investments, and so on. Some of the key features of the US tax reform include:

- A permanent substantial reduction in the statutory corporation tax rate to 21% (from 35%) with effect from January 1 2018 and repeal of the corporate alternative minimum tax;
- A limitation on the deduction of net business interest expenses to 30% of adjustable taxable income;
- A 'temporary' expensing provision that allows taxpayers to immediately write off 100% of the cost of purchase of new or used qualifying property;
- A shift from a system of worldwide taxation with deferral to a worldwide system with favourable treatment of offshore income; and
- The limitation of carry-forward of net operating losses (NOLs) to 80% of taxable income, and elimination of the carry-back of these losses.

The US tax reforms are likely to have a fundamental and far-reaching impact on MNEs. This article, however, focuses on certain key provisions of the US tax reform that are expected to impact MNEs with operations in the Asia Pacific region (and specifically, Australia, China, Japan, Korea, Sri Lanka, and Taiwan) as they impact on their related party arrangements, and it explores what considerations may be relevant for the ASPAC companies.

This article discusses the potential impact of key provisions involved.

Base erosion and anti-abuse tax

A new anti-base erosion measure has been introduced that applies to both US and foreign-based multinationals called the 'base erosion anti-abuse tax', commonly referred to as the BEAT. It is a minimum tax that applies to large corporations that reduce their US tax liabilities below a certain threshold by making deductible payments (e.g. interest, royalties and many services payments) to related foreign entities.

The BEAT generally applies to corporations that are not S corporations, regulated investment companies or real estate investment trusts, with group revenue of at least $500 million of annual domestic gross receipts (over a three-year averaging period) and have a 'base erosion percentage' of 3% or higher (2% for certain banks and securities dealers). The base erosion percentage generally is determined by dividing overseas related party payments that are deductible (subject to certain exclusions) by the total amount of the corporation's deductions for the year. It is relevant to note that costs included in the total cost of goods sold are not considered as deductions because they are a reduction to gross receipts in computing gross income rather than a deduction from gross income. Hence, the cost of goods sold is neither included in the numerator nor the denominator for calculating the BEAT liability. The BEAT rate generally is 5% for 2018, and will be 10% for 2019-2025, and 12.5% after 2025. The BEAT rate is 1% higher for banks and registered securities dealers.

Corporations that meet the base erosion percentage are required to run a separate set of calculations to determine whether they are subject to a BEAT liability. The BEAT provision generally requires a taxpayer to recompute its taxable income as if it had not made any base erosion payments and then multiply that 'modified taxable income' amount by the applicable BEAT rate. If the resultant amount exceeds the taxpayer's post-credit regular tax liability (the BEAT rules provide preferential treatment for four types of tax credits), the taxpayer will generally have a BEAT liability.

Limitation on the deduction of net business interest expense

The new law generally disallows a deduction for net business interest expenses of any taxpayer exceeding 30% of a business's adjusted taxable income (generally earnings before interest, tax, deductions, amortisation – or EBITDA – for the years before 2022, and earnings before interest and taxes – or EBIT – thereafter). In general, business interest expense and business interest income is interest allocable to a trade or business and does not include investment interest expense or income. The law does not grandfather existing debt, meaning that the new limitation also applies to interest on debt incurred before enactment – a key issue for highly leveraged companies. The new interest limitation also can be expected to have a disproportionate impact on corporations that employ a higher degree of leverage, operate in an economic downturn, or experience financial difficulty.

The limitation does not apply to certain small businesses with average gross receipts under $25 million and to certain other classes of entities. Subject to this exception, the provision applies to all businesses, regardless of form, and any disallowance is generally determined at the tax filer or entity level (e.g. at the partnership level instead of the partner level). For a group of affiliated corporations filing a consolidated return, the provision applies at the consolidated tax return filing level.

Subject to special rules for partnerships, any business interest disallowed would be carried forward indefinitely, but would be subject to the tax code's loss limitations in the event a corporation underwent an ownership change. Special rules allow partnerships' or S corporations' unused interest capacity to be used by their partners and shareholders.

Foreign-derived intangible income

The new law creates a new category of 'foreign-derived intangible income' (FDII). The new law provides a 13.125% effective tax rate (increasing to 16.406% in 2026) on FDII earned directly by a US corporation from foreign sales, leases, licences and services. The reduced effective tax rates are achieved through a special deduction by the US corporation. At a high level, a US corporation's FDII is its net income from export activities reduced by a fixed 10% return on its depreciable assets used to generate the export income. Presumably, the goal of this provision is to provide an incentive for US companies to locate productive assets in the US, rather than offshore.

A special rule applicable to related-party transactions provides that if a US taxpayer renders services to a related party outside the US, its services will not qualify as FDII. This is the case even if the related foreign person might ultimately use the US services to complete its service obligations to unrelated persons outside the US, unless the US taxpayer can demonstrate that its services are not substantially similar to services the related foreign person provides to persons in the US.

Impact of the US tax reform on the Asia-Pacific region

Australia

Inbound companies

Many US MNEs have set up operations in Australia in the form of local service entities supporting the US parent. Often, these local Australian subsidiaries are structured as sales and marketing service entities supporting the offshore principal in making Australian sales. These service entities are generally compensated on a cost-plus basis with payments flowing from the US to Australia. These payments will often come under the purview of BEAT, potentially resulting in additional tax liability for the US parent.

These structures are also on the Australian Tax Office's (ATO) radar under the new anti-avoidance rules (Multinational Anti-Avoidance Law and Diverted Profits Tax) and they are likely to be reviewed by the ATO at some point.

In order to manage the risk, both from a US and Australian perspective, we have observed companies transitioning the Australian operations from a service provider to

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Jay has worked in Australia and India providing global assistance across a broad range of industries and sectors, including technology, retail and consumer, manufacturing, specialty chemicals, financial services and industrial products.

Jay has assisted many global multinationals in planning, documenting and defending their global transfer pricing positions. This includes preparing transfer pricing documentation, negotiating successful risk review and audit outcomes, and bilateral/unilateral advance pricing arrangements.

More recently, Jay has assisted clients on the evolving BEPS landscape, anti-avoidance engagements, helping global clients manage the introduction of the country–by-country rules regionally as well as managing regional documentation projects.

a buy-sell model. By creating a foreign-based income (i.e. non-US revenue), the inter-company payments associated with this transaction would not be subject to the BEAT provision. This business model change (subject to appropriate transfer pricing [TP] considerations) may also address the anti-avoidance measures and permanent establishment risks in Australia.

Outbound companies

A reduced US corporate tax rate for exports (i.e. FDII) should encourage Australian companies to expand into new business by way of the following:

- New business expansion and business/company acquisitions in the US; and
- Evaluation of transferring existing assets and functions into the US, such as intellectual property; and principal and other supply chain functions (for both US and non-US sales).

However, care should be taken when deciding how to finance future acquisitions and operational cash needs of the US business in light of the new interest expense limitation rules. These rules do not grandfather existing debt. Hence, highly leveraged companies will need to consider the impact in the context of existing capital funding structure and evaluate ways to mitigate the consequences.

China

Less than a week after the US tax reform was signed into law, China released the Caishui (2017) 88 (Circular 88) and relevant interpretations, introducing a withholding tax (WHT) deferral incentive for profit reinvestments in China. In accordance with Circular 88, profits derived by a foreign investor from resident companies in China will be entitled to a tax deferral incentive and temporally will not trigger withholding tax so long as such profits are reinvested (e.g. through capital increase, capital injection or share

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Jennifer has assisted clients in a variety of engagements including documentation/filings prepared in compliance with US, Australian and OECD transfer pricing legislation, transfer pricing planning/restructuring, operational transfer pricing, ATO audit reviews, and BEPS compliance (country-by-country reporting, master file and local file).

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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 adviser 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 before returning to China in 2004.

purchase) in 'encouraged projects', if certain conditions are met. The benefit is applicable for profits distributed on or after January 1 2017, and signals the country's drive to continuously attract and retain foreign direct investment.

In April 2018, President Xi Jinping announced plans to create a free trade zone on the southernmost island of Hainan by 2020, and a free trade port by 2025. It is anticipated that Hainan might be used as a pilot for new fiscal policies to be potentially rolled-out nationwide at a later stage. Reforms like the Hainan free trade zone are expected to create a favourable investment climate as voices within the Ministry of Finance have expressed concerns about the 14% reduction in the headline corporate income tax rate passed with the US tax reform.

It is our understanding that a special task force was formed by the State Administration of Tax to study the impact of the US tax reform on China and more measures and actions are anticipated as a result of this effort.

Japan

For Japanese companies, US tax reform may have an important impact on both business and tax strategy. We understand that the major discussion points from Japanese companies' and the National Tax Agency's (NTA's) perspectives are as follows:

- The impact of the reduction in US corporate tax rate: Despite the recent gradual reduction of the corporate tax rate in Japan, the change to the US corporate tax rate may result in the movement of functions to the US. Specifically, the NTA is concerned that Japanese companies may shift value-creating functions such as manufacturing and research and development functions to the US. Such a shift may result in increased audit activity and a review of possible exit tax implications.
- The impact of BEAT: Several Japanese companies engage in transactions with related entities in the US which will be impacted by the BEAT provisions (such as

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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.

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Lin 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, Lin was seconded to KPMG in Singapore's transfer pricing practice and engaged in a variety of international transfer pricing projects.

Lin is a US certified public accountant and holds a MSc degree in international business and management from the UK, and has a bachelor's degree in accounting administration from Taiwan.

commission or royalty payments). Further, given that there are several advance pricing arrangements (APAs) and mutual agreement procedure (MAPs) cases in place between Japanese and US companies, it will be important that taxpayers clearly define transaction types and cost items in APA applications with the BEAT in mind. It is unclear whether taxation of the BEAT can be treated in the APA or MAP processes between the Internal Revenue Service (IRS) and the NTA and this point will need to be clarified.

Korea

Historically, Korean companies have diligently transferred intangibles acquired and/or developed in the US to Korea due to the low effective tax rate in Korea and their existing transfer pricing policies. With the introduction of the new US tax exemption for exports (i.e. FDII), Korean companies may evaluate the effective tax rate benefit of retaining any intangibles in the US. However, in practice, our observations suggest that it is unlikely that Korean companies will actively restructure the ownership of any intangibles simply because of the lower tax rate given. There are several other relevant considerations.

Sri Lanka

Sri Lanka's two main foreign exchange earning sectors engaged in trade with the US are the garment and information technology (IT) sectors.

Numerous incentives are granted to these sectors via Sri Lankan income tax law to promote and enhance foreign exchange earnings, and these sectors are taxed at a concessionary rate of 14% with the introduction of the new income tax law effective from April 1 2018. The IT sector has been granted further incentives through an additional 35% deduction on staff costs. Although these developments were not in response to the US tax reform, operations in Sri Lanka continue to be tax beneficial, due to the aforesaid incentives.

Moreover, due to advantages of labour arbitrage and trade and customs incentives through first sale for export arrangements, enterprises still consider it advantageous to invest and continue operations/trade relations with Sri Lanka. Accordingly, Sri Lanka could be viewed as being less impacted than other jurisdictions in the region by the US tax reform.

Taiwan

Due to the unavailability of tax treaties between the Taiwan and the US, the repatriation of profit from the US to Taiwan

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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 leads the transfer pricing unit of KPMG in Sri Lanka. KPMG in Sri Lanka is a market leader in transfer pricing and has won engagements in fast-moving consumer goods, apparel, IT service and industrial sectors. Shamila also works very closely with the Department of Inland Revenue and has 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.

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Jee-Won has been heavily involved with foreign invested companies in Korea assisting their TP issues such as BEPS compliance, TP planning, and audit review.

headquartered companies is subject to 30% withholding tax. As a result, Taiwan corporations may not be prompted to invest in the US despite the reduction in the US corporate tax rate to 21% (from 35%).

The introduction of the BEAT and the limitation of interest deductions is likely to cause Taiwan corporations to closely review existing TP policies, value chain arrangements and financing structures and to reconsider some modifications in relevant related-party transactions to minimise the potential tax implications. As a result, Taiwan companies may re-evaluate the effect of restructures and assess related-party transactions to be in accordance with the US tax reform; however, the full importance of the US tax reform is still to be observed.

Final thoughts

US tax reform presents both opportunities and challenges (risks). Multinational enterprises will need to identify the concrete steps required to capitalise on opportunities and build pragmatic plans to manage and mitigate substantial risks.

KPMG is working to understand the important changes discussed in this article and over time intends to work with our clients to plan actions, including substantially restructuring the way that they conduct business in the US, in order to fully take advantage of the benefits of the new law while actively managing the risks.

Asia Pacific – a harmonious interplay between transfer pricing and customs valuation?

The rise of integrated supply chains, complex organisational structures and inter-company transactions, means the harmonious interplay between customs valuation and transfer pricing has never been more important, writes Leonie Ferretter of **KPMG**. However, across the Asia Pacific region, we continue to see disparity in how TP is treated from a customs perspective.

The commonalities between some of the OECD transfer pricing (TP) methods and the customs valuation methods contained in the World Trade Organisation valuation agreement (the agreement), have not so far converged to the point where we have regional consensus on how to treat TP adjustments for customs purposes. Additionally, despite the fact that Asia Pacific countries are parties to the agreement, which recognises that the price between related parties is not, in and of itself, reason to question the pricing between those parties, related-party transactions and post-importation adjustments continue to raise the customs risk profiles of importers across the region. Of course, in some countries, this risk is considerably increased where there are higher duty rates, high rates of customs penalties and very active customs audit regimes.

The maturity level of dealing with customs-related party pricing and post-importation adjustments differs greatly across countries in the Asia Pacific region.

At one end of the spectrum countries such as Australia have:

- Formal, publicly available customs valuation TP policies;
- The ability to obtain related party pricing valuation rulings (which provide protection from customs penalties);
- Access to customs duty refunds for post-importation adjustments; and
- Bulk disclosures and payments for post-importation increases to price, customs duty and goods and services tax/value added tax.

At the other end of the spectrum:

- Some countries have limited, if any, guidelines on TP and customs valuation;
- Post-importation adjustments can result in customs audits upon disclosure, or there is no mechanism to disclose such adjustments;
- There is an inability to obtain customs duty refunds for price decreases;
- There can be penalties for short payments of customs duty and value added taxes where there are price increases; and
- Importers can have inter-company prices for goods revalued by customs authorities.

The question of how clients can mitigate customs risks related to TP is one that we, as professional advisers, are faced with on a daily basis. This question, and the question of how we can help provide a level of consistency across the region is not one that is easily answered. However, as a general principle the very first step in mitigating customs risks is to ensure that TP and customs valuation principles and laws are examined in concert and that customs valuation is not an afterthought – after the

transfer prices and methods have been set and certainly not at the time post importation adjustments arise.

Organisations must be cognisant that TP methods that best suit customs transactions in Europe and the Americas may not necessarily be as easily dealt with for customs transactions across the Asia Pacific region.

It is also worthwhile noting that, while income tax authorities will generally seek to determine whether or not an appropriate level of profit has been achieved at an entity level, customs authorities seek to determine whether the price of goods in any individual transaction has been affected by the relationship between the parties so as not to understate the value and associated duty liability.

In the context of understanding that customs duty is a transactional tax, in the Asia Pacific there are often high duty rates, little policy on dealing with TP adjustments for customs valuation and considerable customs audit activity. It is important that organisations put in place solid mechanisms to deal with the relationship between TP and customs valuation.

Some simple strategies to deal with the interplay between TP and customs valuation can include:

- Understanding the customs regulatory environment you are dealing with at a country level;
- Achieving a full understanding of and comfort with how the relevant customs regime deals with post-importation adjustments and other inter-company payments (such as royalties, production assist costs, research and development costs, and management fees);
- Preparing a customs-related party pricing analysis at the same time TP policies are documented;
- Obtaining customs valuation rulings where available and, where not available, preparing country-specific customs valuation position papers;
- Ensuring tax and trade teams understand the interplay between the relevant authorities and include customs valuation in internal TP and tax policies and procedures;
- Ensuring inter-company legal agreements reflect company practices and consider the customs and tax treatments of relevant countries; and
- Making sure the business has an escalation process for experienced trade and tax teams to deal with valuation enquiries and audits by customs authorities.

Experience has shown that the harmonious interplay between TP and customs valuation across the Asia Pacific region is some way off. However, it can be achieved with planning, knowledge and bringing customs teams together with TP and tax teams to help ensure tax and customs outcomes play equal roles in inter-company pricing management.

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Leonie assists clients across a variety of industries within the Asia Pacific region on customs duty management, duty savings methodologies, compliance matters, use of free trade agreements, complex customs valuation, tariff and origin matters.

Leonie has strong working relationships across the KPMG network and works closely with tax, supply chain and procurement teams, in managing trade and customs outcomes on large-scale projects.

Transparency is trending

Over the past year, the Australian transfer pricing (TP) landscape has continued to evolve. There is new legislation and the Australian Taxation Office (ATO) is continuing to prioritise TP as a key area, write Tim Keeling, Jay Mankad and Jennifer Goldkopf of **KPMG**.

The commencement of other BEPS measures, such as the diverted profits tax (DPT), and their interaction with Australian TP provisions means that the focus on TP is continuing to increase.

Overlaying this is the increased focus on transparency. The expectations regarding transparency from the Australian Tax Office (ATO) have continued to increase through new compliance requirements and initiatives. Taxpayers that are significant global entities (SGEs) already have or shortly will lodge their first country-by-country (CbC) reports, providing the ATO with a large amount of new information to better analyse taxpayers and identify strategic patterns and trends. The ATO will also be able to access CbC information from other tax authorities with exchange treaties very soon, which should facilitate further international collaboration on the international affairs of taxpayers by tax authorities.

The ATO has also provided additional or updated guidance with respect to various TP-related matters. This guidance, which focuses on intra-group debt, procurement hubs and the potential application of the DPT, seeks to communicate the criteria or situations in which the ATO considers particular international arrangements to be relatively high or low risk. Further guidance is expected later this year in relation to other key TP areas such as guarantee fees and derivatives.

This country update discusses the above matters in further detail.

New legislation

As part of the 2018 to 2019 federal budget, for income years commencing on or after July 1 2018, the definition of an SGE will be broadened to include members of large multinational groups headed by private companies, trusts and partnerships. It will also include members of groups headed by investment entities. This may result in foreign investment funds and foreign pension funds being deemed SGEs.

Significant global entities are subject to CbC obligations and this may result in a disconnect between the manner in which a multinational classifies an Australian operation for CbC purposes in its headquarter jurisdiction compared to how this operation may be classified in Australia. Careful monitoring will be required to ensure that taxpayers are abreast of any potential issues and additional compliance requirements that may arise from this change.

ATO programmes

ATO justified trust reviews

A key phrase in the OECD paper on tax control frameworks is 'justified trust' – a concept of using tax control frameworks to justify trust in taxpayers getting their tax calculations correct and managing their tax affairs in a way in which the tax authority or other stakeholders may have faith. The ATO has noted that the purpose of justified trust is to build and maintain community confidence that taxpayers are paying the right amount of tax, and to allow the ATO to focus its resources in the right areas.

The ATO notes that to achieve justified trust, "we seek objective evidence that would lead a reasonable person to conclude a particular taxpayer paid the right amount of tax. This is a higher level of assurance than confirming certain risks do not arise".

Through the undertaking of streamlined assurance reviews, the ATO has indicated that it will seek to review the affairs of taxpayers earning revenues greater than $250 million. This initiative is expected to result in approximately 1,000 taxpayers being subject to review over the next four years, with taxpayers potentially subject to greater scrutiny should tax risks be identified. It is important to note that the reviews have already started and the ATO is in the process of gathering the relevant information and evidence and completing the reviews for various taxpayers. A sample of questions that the ATO may ask are publicly available, divided into four categories being:

- Alignment between accounting and tax rules;
- Tax governance and risk management;
- Significant and new transactions; and
- Tax risks flagged to market.

Among other things, the reviews are expected to focus on the existence, application and testing of a tax risk management and governance framework at the Australian level, as well as substantial transactions and their associated tax outcomes. As such, the existence and quality of taxpayers' TP documentation (including information regarding the global value chain in its entirety) is an important component of demonstrating justified trust as part of these reviews.

These reviews occur over a short time period, with most being finalised within six months, at which point a decision is made by the ATO as to whether to escalate any identified tax risks. As such, it is of greater importance that taxpayers are prepared with contemporaneous documentation and evidence before such reviews occur, as the ATO's expectation is that requested information will be provided in a comprehensive and timely manner. In this regard, the ATO generally allows 28 days to comply with the request for information, with limited opportunities for an extension.

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Tim Keeling has more than 12 years of experience in transfer pricing, with more than three and a half years of experience in the Australian Tax Office's TP unit. As a result, Tim has extensive TP experience 'on both sides of the desk' and, in this regard, has dealt with numerous TP matters.

Tim has experience with respect to numerous industries including financial services, consumer markets, pharmaceuticals and e-commerce, and he thrives on being able to provide practical solutions to complicated issues such as intellectual property and financial transactions.

During Tim's career he has worked on a wide range of engagements across various jurisdictions, building substantial operational and technical knowledge, as well as key relationships with ATO personnel. This allows Tim to design effective and commercial strategies that balance the interests of multiple stakeholders.

International Compliance Assurance Programme

As of January 2018, the ATO is participating in the pilot of the International Compliance Assurance Programme (ICAP), launched by the OECD. This programme complements the justified trust initiative discussed above.

The ICAP involves various tax administrations undertaking cooperative multilateral risk assessments on multinational taxpayers using country-by-country (CbC) reports and other relevant information to assess TP and permanent establishment risks.

A pilot has commenced under the ICAP, involving eight OECD member tax administrations, being Australia, Canada, Italy, Japan, the Netherlands, Spain, the UK and the US. Each nation has one headquartered company subject to the programme.

ATO guidance

ATO diverted profits tax guidance

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.

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Jay has worked in Australia and India providing global assistance across a broad range of industries and sectors, including technology, retail and consumer, manufacturing, speciality chemicals, financial services and industrial products.

Jay has assisted many global multinationals in planning, documenting and defending their global TP positions. This includes preparing TP documentation, negotiating successful risk review and audit outcomes, and bilateral/unilateral APAs.

More recently, Jay has assisted clients on the evolving BEPS landscape, anti-avoidance engagements, helping global clients manage the introduction of the country-by-country rules regionally, as well as managing regional documentation projects.

The DPT will apply to SGEs carrying on business in Australia. The DPT applies from income years commencing on or after July 1 2017.

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 importantly, 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.

Certain exemptions apply to certain types of trusts, vehicles and funds, and the DPT will also not apply if sales are of a relatively low materiality (generally less than $25 million), if sufficient foreign tax is paid offshore (generally at least 80% of the Australian reduction), or if sufficient economic substance (SES) exists within the relevant members of the scheme (based on TP principles). In practice, supporting that SES exists will be a key area of focus for taxpayers to support that the DPT is not applicable.

The ATO has estimated that 1,470 taxpayers are within the scope of DPT and 130 are in the 'high risk' category. As a result, the ATO has released draft Law Companion Ruling (LCR) 2017/D7 and draft Practical Compliance Guideline (PCG) 2018/D2 to assist taxpayers that may be affected by DPT. The draft LCR clarifies various concepts and explains how the ATO will apply the DPT law to provide taxpayers with greater certainty on the application of the law.

The draft PCG sets out the ATO's client engagement framework for the DPT and outlines the ATO's approach to risk assessment and compliance activity. It also provides examples to illustrate the relative risk of adopting certain types of arrangements in the context of the DPT based on different industry sectors and functional profiles. In this regard, the examples include situations relating to lease-in lease-out arrangements, intangibles migration and run-up run-down, limited risk distributors, marketing hubs and insurance arrangements. The guidance also outlines that an agreed advance pricing arrangement (APA) with the ATO will generally result in a low-risk classification for DPT purposes.

Finalised guidance on cross-border related-party financial arrangements – PCG 2017/4

Following a seven-month consultation process, the ATO has published final guidance on cross-border related-party financial arrangements, which sets out its approach to assessing risk in respect of related-party cross-border financing arrangements. The PCG applies retroactively to financing arrangements existing or coming into operation on or after July 1 2017.

The measures imposed under the PCG enable taxpayers (and the ATO) to assess the risk profile in relation to their cross-border financing arrangements. Applying the framework outlined in the PCG, the ATO will assess cross-border related-party financing arrangements according to a colour-coded tax risk matrix.

The PCG aims to provide guidance to taxpayers as to what indicia the ATO will take account of when determining the degree of compliance resources to allocate to an intra-group loan arrangement (e.g. based on the features of the arrangements, the profile of the parties to the arrangements and the choices and behaviours of the taxpayer's global group). These considerations are bifurcated into two broad groups under 'motivational' and 'pricing' headings. Practically, this means the risk assessment approach involves point scoring under the two categories and mapping the result in a table against two axes.

The ATO has indicated that arrangements that are considered high risk or above would be subject to review as a matter of priority. Moderate risk ratings would still be subject to review, albeit the ATO has indicated a willingness to work with taxpayers and resolve areas of difference.

ATO draft guidance on non-core procurement hubs

In June 2018, the ATO released a draft of proposed Schedule 2 to PCG 2017/1, intended to be effective for income tax years commencing on or after January 1 2018, which will focus on non-core procurement hubs. Similar to the guidance in Schedule 1 of PCG 2017/1 (which relates to marketing hubs), a colour coded matrix applies which is driven by the 'tax at risk' and the degree of TP documentation prepared in accordance with ATO TP rulings.

Broadly, to determine tax at risk, taxpayers must determine the degree to which the non-core procurement hub's profit is greater than operating costs plus 25%. Other factors will impact the calculation (such as the degree of controlled foreign company income that may be attributable). Non-core procurement hubs that earn less than cost plus 25% will be considered low risk from an Australian perspective.

This new schedule being proposed will have broad coverage, and will be relevant for numerous industries (such as natural resources) as well as for multinationals looking to rationalise supply chains.

Update on country-by-country reporting

The first year of CbC reporting (CbCR) compliance in Australia has so far resulted in the lodgement of over 2,100 Australian local files (ALF), 1,463 master files, and 42 CbC reports with the ATO. As taxpayers prepare for the second year of CbC compliance in Australia, taxpayers should be aware that there are various key changes to the ATO template for the second year. These include:

- A requirement for substantially more detail to be included in the short-form local file;
- A more granular disclosure of third-party expense recharges; and
- Greater detail related to foreign exchange gains/losses and deferred foreign currency arrangements.

International dealings schedule

The ATO has also included additional questions in the international dealings schedule (IDS). Among other things, taxpayers must now disclose if their international related-party dealings are subject to 'hub' arrangements as outlined in the ATO's relevant guidance, being PCG 2017/1. Taxpayers must also disclose if the taxpayer undertakes contract research and development (R&D) services for an international related party. Clearly these additional questions focus on key risk areas and may allow the ATO to better understand where to dedicate resources for matters such as the DPT.

Other developments

Senate committee report part III

The Australian senate economics references committee recently released its final report of inquiry into corporate tax avoidance in Australia. The report, titled 'Much heat, little light so far' outlines 13 recommendations. The committee's recommendations are non-binding but include the following:

- Amending the thin capitalisation rules so that the worldwide gearing ratio is the only method by which interest-related deductions should be calculated for the purpose of tax treatment in Australia;
- Exploring options to modify TP rules, or other tax laws, to ensure multinational enterprises make the appropriate contribution to Australian tax revenue; and
- Requiring publication of excerpts of CbC reports be made publicly available free of charge.

The economics committee's recommendations further demonstrate the degree of scrutiny being placed by broader stakeholders on the TP arrangements of taxpayers, as well as the expectations regarding transparency in the Australian tax environment.

Upcoming ATO guidance

We expect the ATO to release the following guidance in the near future:

- Guidance related to the interaction between the TP rules and debt/equity rules;
- Guidance related to derivatives and guarantees; and
- Further guidance in relation to the application of the arm's-length debt test.

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Jennifer has assisted clients in a variety of engagements including documentation/filings prepared in compliance with US, Australian and OECD transfer pricing legislation, transfer pricing planning/restructuring, operational transfer pricing, ATO audit reviews, and BEPS compliance (country-by-country reporting, master file and local file).

Conclusion

The Australian TP landscape continues to evolve and become more complex. Significant global entities in particular face numerous challenges in ensuring that their TP affairs are in order and well supported. With the enactment of the DPT and with CbC information now available to the ATO, it is more important than ever that taxpayers ensure they are well resourced and prepared to navigate the Australian TP landscape.

TP in China: SAT tapping into the tax big data paradise

As explained by Cheng Chi, Rafael Triginelli Miraglia and Choon Beng Teoh of **KPMG**, transfer pricing continues to be one of the Chinese State Administration of Taxation's key areas of focus, as new policies and methodologies are being examined post-BEPS to strengthen the SAT's monitoring of multinational enterprises' TP.

The most notable development on the compliance enhancement front is the Jiangsu Provincial Tax Bureau's (JSTB) pioneering of a new profit monitoring mechanism for MNEs that will likely be rolled out nationwide in the near future. In tandem with this, the audit focus has shifted towards taxpayers exploiting the Chinese market, whilst making significant royalty or service payments to overseas affiliates.

Being an active proponent of the anti-BEPS initiatives, China has been working hard to enhance its tax transparency agenda and dispute resolution mechanisms. China was a first mover on the introduction of country-by-country (CbC) report filing obligations and it has committed to issuing formal interpretative guidance in the coming months.

On the dispute resolution front, we see a surge in China's efforts to resolve mutual agreement procedures (MAPs) with numerous competent authorities (CA) meetings with treaty partners being conducted and/or planned despite the persistent shortage of resources on the part of the SAT. The concerns that the MAPs would compromise China's ability to process the backlog of advance pricing arrangements (APA) has to a large degree faded, as many of the pending APAs are being added to the CA's agenda. This shows China's intention to cater to the growing demands of advance certainty by the taxpayers in the wake of anti-BEPS actions around the world.

Enhancing transfer pricing compliance and shifting of the audit focus

April 2018 saw the release of a new profit monitoring mechanism by the JSTB as part of the SAT's initiative to strengthen transfer pricing compliance activities on MNE taxpayers. The key feature of the programme is that selected taxpayers will be constantly monitored and ranked on a risk matrix based on multiple quantitative and qualitative criteria. It is expected that the mechanism will be implemented nationwide. To this end, the JSTB recently organised a seminar, attended by approximately 150 MNEs operating in the Jiangsu province, as well as advisers, to elucidate the new profit monitoring mechanism.

The main thrust of the profit monitoring mechanism is to enhance risk and compliance management oversight, aided by big data analysis. Instead of targeting all taxpayers that engage in cross-border related-party transactions, the authorities would selectively classify companies according to provinces, cities and districts, for clearer identification of "high risk" entities for constant monitoring that would likely result in swifter and targeted regulatory actions.

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Cheng Chi is the head of KPMG global transfer pricing services for China and Hong Kong SAR. Cheng has led many transfer pricing and tax efficient supply chain projects in Asia and Europe, involving advance pricing arrangement negotiations, cost contribution arrangements, pan-Asian documentation, controversy resolution, global procurement structuring, and headquarters services recharges for clients in the industrial market including the automobile, chemical, and machinery industries, as well as the consumer market, logistic, communication, electronics and financial services industries.

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 adviser 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 before returning to China in 2004.

Extensive information gathering for big data analysis

To enable successful implementation, the tax authorities have launched a risk assessment framework that involves extensive tax and transfer pricing qualitative and quantitative information gathering. The annual contemporaneous transfer pricing documentation, which has detailed disclosure requirements under a revised regulation issued two years ago, forms one of the sources of information to effectuate the profit monitoring mechanism. Other information sources such as group annual reports, CbC reports, cross-government departmental data exchange, securities analyst reports, general news reports, etc., make up a comprehensive data source for the tax authorities. The information gathered focuses on basic business conditions, related-party transaction data, functional profile information, group information, detailed industry conditions, value chain information, etc. — all information would be harvested and inputted into the tax authorities' IT systems as part of a big data analysis.

Profiling of taxpayers on a risk matrix

The analysis churned out from the data would then be used by the authorities to conduct tax risk and compliance assessments on MNE taxpayers. The tax risk assessment focuses on group overall tax planning arrangements and intercompany transactions that are deemed complex, while the compliance assessment focuses on the degree of compliant disclosures of relevant information. Using both dimensions of the assessment framework, the authorities would classify the MNE taxpayers on a risk matrix based on qualitative and quantitative criteria.

Integral to the risk framework assessment, the Chinese tax authorities are expected to continually focus on the Chinese entities' contribution to the MNE's value chains and therefore the Chinese entities' share of profits. Two key elements of the assessment include:

- The emphasis on the consistency between the functional profiles of the entities along the value chains and the profit attributed to these entities; and
- Chinese market factors that contribute to the value creation process throughout the value chain.

To this end, it would not be a surprise for the Chinese tax authorities to request as much data as possible (it could be either through the CbC reports or other additional data request) to enable them to assess the reasonableness of profits earned by the Chinese entities.

Engagement between tax authorities and taxpayers likely to increase

High-risk taxpayers identified through the risk assessment framework should expect to receive warning notices, and it would likely result in taxpayers proactively engaging with the authorities to address the risk issues, such as performing transfer pricing adjustments voluntarily. Taxpayers that do not take any actions would remain high on the risk matrix and may eventually be subject to formal special tax investigations. It is expected that the new monitoring mechanism will lead to more dialogue between taxpayers and the tax authorities.

The increased engagement between taxpayers and tax authorities will likely result in a less confrontational audit environment. On the flip side, the constant monitoring of profit levels of MNE taxpayers by the tax authorities may exert pressure on taxpayers to meet the expectations of the tax authorities on a continuous basis.

While the reduction in investigations is a welcome sign of a maturing Chinese transfer pricing regime, the extensive information request may prove challenging for MNEs, more so for those with a multi-faceted supply chain and with complex IT systems that could not readily satisfy the authorities' request for data, especially considering China's 10-year enquiry window for transfer pricing adjustments. The increased expectations of the tax authorities on obtaining

quality information with the contemporaneous documentation, as well as with subsequent information requests, would inevitably increase the compliance costs for taxpayers.

Audit focus is shifting

Hand in hand with the introduction of the compliance programme outlined above, a new trend is emerging, whereby the number of formal transfer pricing audits are declining, resulting in a shift of focus in the audits carried out. The decline probably stems from the Chinese tax authorities' efforts in creating a more communicative and cooperative compliance environment for MNEs. The current audits appear to be focused on taxpayers exploiting the Chinese market. In particular, greater scrutiny is expected on taxpayers who pay a significant amount of royalties and/or service fees to overseas related parties, despite having a largely domestic supply chain (e.g. buying, making and selling in China).

Such an audit focus is in line with the Chinese view that market access-related benefits, whether in the form of market premium or the contribution by the Chinese entity in promoting the products in China, should be captured in the taxable profits of the Chinese entity to reflect the importance of such market features or functions. Royalty and service fees, which are usually justified by the contribution from overseas related parties, are being challenged in audits as disproportional or downright inappropriate. The critical issue is whether the underlying intangibles or centralised functions are truly as valuable in the Chinese market as claimed, especially *vis-à-vis* strategic market features, such as local purchasing power, and the efforts and responsibilities of the Chinese entity.

On the other hand, companies that focus on production for overseas markets, which were primary audit targets for a long time, are less often challenged by the Chinese tax authorities.

China's transparency and international cooperation agenda

MAP and APA trend

China has been active in promoting the transparency and international cooperation agenda whilst gradually implementing measures such as multilateral exchange of CbC reports, with the UK, Germany and France in the first wave of activated CbC exchange relationships.

In the meantime, China is among the jurisdictions that committed to implement the OECD's BEPS minimum standards. A critical aspect of the minimum standards related to Action 14 is the peer review process, where the effectiveness and efficiency of a jurisdiction's MAP are assessed by its peer jurisdictions. While China's MAP regime had not yet been analysed after the third round of stage 1 peer reviews released in March 2018, the OECD guidance released in October 2016 provides that stage 1 peer reviews of all 44 countries that committed to the minimum standards should start before the end of 2018.

The SAT has been tackling the large number of MAP cases as matter of priority – market intelligence indicates that a number of pending MAP have been reactivated with the aim of reaching an expedited solution. Year to date, we also see a large number of MAPs being resolved, albeit in some cases through a pragmatic approach, focused on maximising the benefits of eliminating double taxation for the long run. On the APA front, it is expected that the enhanced process introduced by the 2016 legislation will contribute to the programme's faster resolution and effectiveness, as the number of applications continues to increase. The expedited resolution of MAPs also enhance the SAT's capacity to process the growing number of APAs, including the ones that saw limited progress in the past few years. Another welcome development is that the SAT has increased resources to deal with the MAP/APA at the central level, whilst local bureaux also seem to be devoting more resources to dispute resolution as a result of the combination of the former two-system tax bureaux at the local level.

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Rafael is a law graduate (*Universidade Federal de Minas Gerais*, Brazil, 2004) and has also obtained a master's of laws (PUC-MG, Brazil, 2008) and an LLM in advanced studies in international tax law (International Tax Centre, Leiden University, the Netherlands, 2011). He is a TP lecturer at Leiden University and has taught courses in tax and constitutional law at PUC/MG and customs law at UNA/MG. Rafael has been a member of the Brazilian Bar Association (*Ordem dos Advogados do Brasil*) since 2005.

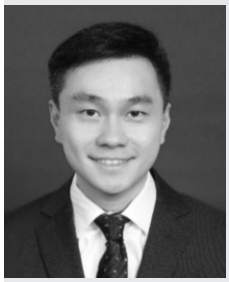
Before joining KPMG China, Rafael worked between 2011 and 2015 as a tax associate with a global law firm in the Netherlands and, before that, as head of tax with a Brazilian law firm.

Final thoughts

China is taking significant steps to harness technological developments and bring public governance to the 21st century. The Chinese tax authorities have been rapidly ramping up their use of big data analytics for tax risk assessment and audit targeting.

Taxpayer-related data sources available are anything but scarce: from transfer pricing disclosure forms, contemporaneous documentation, audit information collection, as well as data from other governmental bodies such as the Ministry of Commerce and State Administration of Foreign Exchange. The SAT is making significant investments in technology, including high capacity IT systems, advanced software applications and data warehousing capabilities to build an effective control system which integrates all industries, tax types and taxpayers in a single platform.

As a result, audit activity and the way taxpayers engage with tax authorities will change substantially. With greater resources devoted to desktop audits, field investigations will likely become less frequent but more incisive and effective. At the same time, as the tax function moves up in the value chain and becomes clearly strategic, taxpayers will need to invest in compliance systems and resources to ensure that going forward they can keep pace with the ever increasing demands from the tax office.



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Choon has experience in multi-jurisdictional planning studies, dispute resolution, value chain analysis and restructuring of operating models, as well as leading and managing global TP documentation projects. His client portfolio includes top-tier multinational companies across a variety of industries including the pharmaceutical, retail, and IT industries. He also occasionally co-authors articles on China-related TP topics for publications.

Choon graduated with a law degree from the London School of Economics and is a chartered accountant with the Institute of Chartered Accountants in England and Wales. Before joining KPMG China, Choon practised in another leading accounting organisation in London in the area of international tax and TP.

The transfer pricing landscape in India

Almost two decades after the introduction of transfer pricing regulations in 2001, the Indian TP space has evolved and matured immensely, write Manoj Pardasani, Hasnain Shroff and Hardev Singh of **BSR & Co**. Today, India's TP regulations are in line with international TP principles and the Indian government is continuing to align the TP regulations with global best practices.

In 2016, India adopted the three-tier transfer pricing (TP) documentation structure as prescribed by the OECD under BEPS Action 13. Further, provisions relating to secondary adjustments and thin capitalisation were also introduced into Indian regulations in 2017.

Over the past few years, the government has made several efforts to strengthen the dispute resolution mechanisms available in India, like the introduction of the advance pricing agreement (APA) programme in India in 2012 which has so far been hugely popular with the taxpayers. India also introduced safe harbour provisions in 2013, which were then revised in 2017, wherein most of the safe harbour rates were rationalised and safe harbour provisions for the receipt of low value adding intra-group services were introduced.

Secondary adjustments

Where, as a result of primary adjustment to the transfer price, there is an increase in the total income or reduction in the loss for the taxpayer, the excess money which is available with its associated enterprise (AE), if not repatriated to India within the time as prescribed, will be deemed to be an advance made by the taxpayer to such AE and the interest on that advance will be computed as the income of the taxpayer, in the manner prescribed.

'Secondary adjustment' has been explained as an adjustment in the books of accounts of the taxpayer and its AE to reflect that the actual allocation of profits between the taxpayer and its AE are consistent with the transfer price determined as a result of primary adjustment, i.e. based on the arm's-length price as may be determined.

A taxpayer is required to make a secondary adjustment, where the primary adjustment (with effect from financial year [FY] 2016 to 2017) to transfer price has been made in the following situations:

- *Suo motu* by the taxpayer in the return of income;
- By the assessing officer (AO) during assessment proceedings, and has been accepted by the taxpayer;
- An adjustment determined by an APA entered into by the taxpayer;
- An adjustment made as per the safe harbour rules (SHR); or
- An adjustment arising as a result of the resolution of an assessment by way of mutual agreement procedure (MAP).

A secondary adjustment would not be applicable, if the amount of a primary adjustment made did not exceed INR10 million ($150,000).

While the secondary adjustment provisions are aimed at preventing the erosion of the asset base from India, there are certain aspects that cause hardship for taxpayers and their AEs. Associated enterprises situated in jurisdictions outside India are required to make cash remittances to taxpayers in India, which would obviously require the AE to (i) make accounting entries consistent with Indian requirements, and (ii) seek tax deductibility in the other jurisdiction. Further, the tax administration of the other jurisdiction would need to review the arm's-length nature of the secondary adjustment (made from India) and allow a similar adjustment in its country.

This requirement in Indian tax law is extremely onerous for the AE and tax administration of the other jurisdiction. If the cash remittance against the secondary adjustment is not brought into India, an imputed interest would be added to the taxable income of the taxpayer in India in perpetuity, which is most undesirable for any multinational enterprise (MNE).

The situation described above gets even more intricate when the Indian taxpayer has multiple transactions with different AEs which are all aggregated for a combined arm's-length review (say, in a transactional net margin method, resale price method, or cost plus method). The resultant primary adjustment is easy to determine and directly impacts the determination of taxable income. However, to implement the corresponding secondary adjustment, i.e. to receive a cash remittance, one needs to attribute the same to one or more of the multiple AEs, which would give rise to further issues.

Thin capitalisation

In line with the recommendations contained in the BEPS Action Plan 4 issued by the OECD, amendments relating to thin capitalisation were introduced into the Indian regulations in 2017.

Where an Indian company, or a permanent establishment (PE) of a foreign company in India, being the borrower, pays interest exceeding INR10 million in respect of any debt issued/guaranteed (implicitly or explicitly) by a non-resident AE, then such excess interest will not be deductible in computing income chargeable tax.

Excess interest shall mean the total interest paid/payable by the taxpayer in excess of 30% of cash profits or earnings before interest, taxes, depreciation and amortisation, or the interest paid or payable to the AEs for that previous year, whichever is the lower. Although there is a restriction on the deductibility of the interest in the hands of the taxpayer in a particular financial year to the extent it is excess, the same will be allowed to be carried forward for a period of eight years and will be allowed as a deduction in subsequent years. These provisions will be applicable for FY 2017 to 2018 and subsequent years.

Country-by-country reporting, master files and local files

The three-tier documentation structure as per the recommendations of the OECD under Action 13 of the BEPS project were introduced in India with effect from the Indian financial year April 1 2016 to March 31 2017. The country-by-country reporting (CbCR) and master file (MF) requirements were introduced in addition to the already existing local documentation requirements. The detailed rules with respect to CbCR and MF filing obligations were released on October 31 2017.

Country-by-country reporting

The parent entity of an MNE group or an alternate reporting entity (ARE), resident in India, will be subject to CbCR in India from FY 2016 to 2017 onwards, if the total consolidated group revenue of the international group exceeds INR55 billion. The CbC report will be filed with the Indian tax authorities within a period of 12 months from the end of the reporting accounting year.

A constituent entity (CE), of an international group resident in India, will be required to file a CbC report in India, if:

- The parent entity is not obligated to file the CbC report in its country; or
- If there is no agreement for the exchange of CbC reports between India and the country of the parent entity; or
- There has been a systemic failure by that country.

In the above 3 cases, the due date for furnishing the CbC report is yet to be prescribed by the Indian tax authorities.

Master file

The master file consists of part A and part B. Part A is required to be filed by every CE of an international group, whether or not it satisfies the dual thresholds specified below; and part B is required to be filed only by those CEs which satisfy both of the thresholds mentioned in Table 1.

The master file must be filed with the Indian tax authorities on or before the due date of filing of the return of income.

Additional requirements

While the master file requirements as per the Indian regulations are similar to the OECD's recommendations in Action 13, under Indian regulations affected companies must also provide:

- A description of the functional, asset and risk (FAR) analysis of all the CEs that contribute at least 10% of the revenues or assets or profits of the group;
- A detailed description of the financial arrangement of the group, including the names and addresses of the top 10 unrelated lenders; and
- A list of all the entities of the international group engaged in the development and management of intangible property, along with their addresses.

Table 1

	Dual thresholds
1. Consolidated group revenue of the international group for the accounting year exceeds	INR 5 billion
And	
2. The aggregate value of an international transaction:	
• During the accounting year, as per the books of accounts, exceeds	INR 500 million
Or	
• In respect of a purchase, sale, transfer, lease or use of intangible property during the accounting year, as per the books of accounts, exceeds	INR 100 million

Stringent penalty provisions have also been introduced into the Indian TP regulations for failure to comply with the master file and CbCR documentation requirements.

Local file-related regulations that already exist in the Indian TP regulations will continue, and no separate rules in this regard have been announced.

Advance pricing agreements

India's APA programme was introduced in 2013 and received a very positive response from taxpayers. An APA is effective for a period of up to five consecutive years. Further, the rollback of APAs enables taxpayers to apply the transfer prices agreed upon in an APA to be rolled back for a period not exceeding four previous years, subject to conditions. Therefore, an APA in India can now provide certainty for up to a period of nine years.

In the five years since the inception of APAs in India, over 900 APA applications and over 200 APAs have already been concluded. This signifies both the popularity of the APA programme among taxpayers, and the commitment of the government to the programme.

Concluded APAs to date have included resolutions on a gamut of international transactions, like import and export of goods, technical services, marketing support services, software development, engineering design services, administrative/business support services, contract research and development, sales and marketing services, HR consultancy services, clinical research services, receipt of licence fees, and so on.

Transfer pricing issues relating to management charges and brand royalty were also agreed upon in bilateral APAs with the UK in 2016. (See the Central Board of Direct Taxes (CBDT) press release on APAs dated February 1 2016.) Further, in 2018, unilateral APAs on the vexed issue of advertising, marketing and promotion (AMP) expenses were also concluded. Another landmark achievement in 2018 was that the APA authorities accepted the price determined by the customs authorities as the arm's-length price (ALP) for certain imports.

On the bilateral APA front, several bilateral APAs have been signed to date with countries including Japan, the UK, the US and the Netherlands.

Mutual agreement procedures

The mutual agreement procedure (MAP) mechanism in India has been gaining a lot of attention over recent years, with the government making a conscious effort to promote MAP as an effective dispute resolution mechanism.

Until recently, India had a policy of no bilateral APA and MAP applications being accepted in the absence of Article 9(2) in tax treaties. Recently, it has been decided that TP MAP and bilateral APA applications will be accepted, regardless of the presence or otherwise of Article 9(2) (or its relevant equivalent article) in double taxation avoidance agreements (DTAs). This may provide further impetus to the APA and MAP programme in India.

Safe harbours

The existing safe harbour provisions under the TP regulations have been revised and extended for a further period. The revised provisions will now be applicable from assessment year (AY) 2017 to 2018 to AY 2019 to 2020. Most of the safe harbour rates have been rationalised in the revised rules on safe harbours, and provisions for the receipt of low value adding intra-group services have also been introduced. The safe harbour provisions have been extended to receipt of such services by Indian entities under the revised SHRs.

Advertising, marketing and promotion expenses/ marketing intangibles

In the past few years, the issue of marketing intangibles has become very prominent in India wherein Indian subsidiaries of global MNEs incurring AMP expenses have been chal-

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Manoj is considered a thought leader and is credited with several firsts and unique projects in the Indian TP landscape, including the first ever India-UK bilateral APAs, the first ever APAs and MAPs involving group cost allocations, the first ever APAs involving marketing intangibles/AMP (advertising, marketing and promotion) controversy and the first ever APA integrating customs valuations with TP.

Manoj is credited with successfully defending many complex TP controversies at tax tribunals.

Manoj has been actively engaged with the Institute of Chartered Accountants of India (ICAI), having reviewed the 'Guidance Note on Transfer Pricing' and authored the chapter on 'Transfer Pricing' in the ICAI's publication 'Aspects of International Taxation – A Study'.

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Hasnain has been rated as an Indian tax controversy leader for 2016 and 2017 by *International Tax Review*.

He has been instrumental in negotiating the first IT/ITES advance pricing agreement in India and paving the way for many more APAs to be signed in this important industry.

Hasnain has conducted TP/BEPS training sessions for a few revenue authorities outside India.

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lenged by the Revenue. The Indian Revenue alleges that the AMP-related activities add value to the trade mark/ brand (owned by the foreign parent entity) by way of brand building, and the local subsidiary must be compensated by the brand owner (foreign parent) either in the form of a service fee, or reduced/nil royalty payments. Since Indian TP regulations do not provide any specific guidelines on intangibles, other than defining them as part of an 'international transaction', the issue has become a much litigated bone of contention among the taxpayers and the Revenue.

Over the past few years there have been several High Court and tribunal rulings on the AMP issue, in favour of both taxpayers and the tax authorities. However, despite several judicial rulings, the AMP issue is far from being resolved and has now reached the doorstep of the Supreme Court of India. Even though the Supreme Court is expected to deliver a verdict that might put this controversy to rest, it is more likely that the Supreme Court may not rule on the AMP issue in an all-encompassing manner and may only lay out certain parameters, which might provide a broad framework on how to proceed in cases of marketing intangibles. There are various categories of taxpayers seeking a resolution – traders, manufacturers, a mix of trading and manufacturing, service providers, marketing entities, and so on, with each such taxpayer having its own set of peculiar facts. Thus, the broad framework will then need to be applied to the unique facts and circumstances of each case. The critical factor here is the implementation of guidelines expected to be laid down by the Supreme Court.

Conclusion

With BEPS-related regulations being implemented in India and worldwide, and with more information at their disposal, tax authorities are expected to be extensively scrutinising

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MNE businesses. Taxpayers will likely need to have robust underlying documentation and ensure that their global TP policies are aligned to local TP policies in various jurisdictions. In an uncertain post-BEPS world situation, taxpayers may have to proactively identify alternate dispute resolution options like APAs or MAPs to manage their TP issues and achieve certainty.

Indonesia's rapid transfer pricing evolution

Indonesia completed the last step in the introduction of new transfer pricing regulations late last year, report Iwan Hoo, Aaron Brunier and Fachrur Rifqi Nugroho of **KPMG**. While the regulations covering the master file, local file and country-by-country reporting were issued in 2016, the implementing regulations for CbCR were not completed until late December 2017.

Local transfer pricing legislation changes

The only change from a regulatory point of view was the introduction of implementing regulations for country-by-country reporting (CbCR):

- If a qualifying competent authority agreement is available and the country of residence of the parent entity requires the filing of a country-by-country (CbC) report, the Indonesian subsidiary is only required to file a notification;
- A list of qualifying agreements is available on the website of the Director General of Taxation (DGT) and the list is still growing;
- The regulations do allow for surrogate filing;
- The threshold for filing the CbC report is a consolidated revenue of IDR 11 trillion ($765 million) for a domestic group or €750 million ($874 million) for an overseas group, or the local threshold in the country of residence of the parent entity;
- The filing deadline for financial year 2016 is 16 months after the financial year end;
- For subsequent years, the deadline is 12 months after the financial year end;
- The online notification report and the CbC report must be submitted online in XML, unless that is not possible;
- The deadline for US-based groups was extended until May 31 2018, at the last moment; and
- The DGT issued a template for the preparation of the CbC report. There are not many differences with internationally accepted standards, although some parts have to be translated into Indonesian.

The local file and master file regulations have remained unchanged since they were first issued in 2016 and no additional guidance has been issued. The general TP guidance was last updated in 2011 and has not changed since.

Release of new administrative guidance by local tax administration

Indonesia has already implemented regulations covering debt-to-equity ratios, allowing a maximum ratio of four to one. Other than that, there have been few developments in this field. It is rare for the DGT to issue public rulings.

The DGT, during public presentations, announced that it intends to raise matters related to business restructuring and exit charges, but nothing has been formalised yet.

BEPS-related developments

There have been no official announcements on any regulatory changes, although the DGT on a few occasions has mentioned it intends to tax global trade and internet commerce, either by deeming them a permanent establishment or requiring the foreign entity to incorporate a local subsidiary in Indonesia. However, no details are available as yet.

Developments in relation to country-by-country reporting

Master file and local file

The local file/master file concept is now in its second year after its introduction in late 2015. The master file requirements are generally in line with international standards, although more information must be provided, such as a list of shareholders, business activities and management of each entity in the group. Also information on which entities in the group contribute to the development of intellectual property should be disclosed.

One other major difference is the emphasis the regulators put on the application of the *ex-ante* concept in the setting of the transfer prices. This is based on Article 5.27 of the OECD guidelines. However, as a practical matter, auditors in the field tend to concentrate on actual numbers (and thus taxes paid) rather than following theoretical approaches. This leads to many disputes, in particular when budgets and actual numbers differ substantially.

Although not a new development, an important matter to consider is the deadline involved, this being four months after the end of the financial year. This is particularly important for the master file, bearing in mind that the master file and local file must be prepared in the local language.

Country-by-country reporting

As noted above, the relevant notification must be submitted online. However, what many taxpayers have discovered to their surprise is that the format in practice is very different from the published form. Instead of completing the form and uploading it, the online notification consists of a number of yes/no questions which guide the taxpayer through the process. An added complication is that the CbC report must be in the local language.

There were also some practical issues during the filing process of the CbC reports, with tax office servers going down and last-minute regulatory changes, but overall we encountered few issues.

Indonesia is also one of the 68 signatories to the CbC multilateral competent authority agreement. At the time of writing, Indonesia has 49 activated exchange of information arrangements in place, although the effective date of some of the agreements is after 2016, so taxpayers with parent entities in for example Malaysia, Singapore and Switzerland cannot yet enjoy the filing exemption. In mid-June, the US and Indonesia announced the completion of the negotiations on a bilateral competent authority agreement. The exchange of information regarding the CbC reports will apply for fiscal years commencing on or after January 1 2015.

US tax reform

The Indonesian regulations contain various thresholds for related-party transactions, and if the transactions do not exceed a certain amount, neither a master file nor a local file need to be prepared by the taxpayer. However, based on the prevailing guidance, the Indonesian Tax Office (ITO) is still able to question those transactions.

Under the new US tax reform, the corporate income tax rate is reduced to 21%. As this rate is lower than the Indonesian rate of 25%, this means that the TP documentation thresholds do not apply and the taxpayer needs to document each transaction with related parties in the US, regardless of materiality.

Transfer pricing compliance activities by local tax administration

A review of the TP policies and practices is almost always included in tax audits and many Indonesian taxpayers are subject to an annual tax audit due to the peculiarities of the Indonesian tax system. The main focus is often on services, with the tax auditors arguing that services have not been rendered or that they provide no benefits. In this respect it is very important to collect contemporaneous documents to provide proof that the services were indeed rendered and beneficial. Any reports, memos, training records, and so on, will be invaluable to substantiate the service charges. The level of any mark-up on costs is often not so much under discussion.

A second issue that arises in many audits is licensing transactions, which are often frowned upon. The issues raised often concentrate on the duration of the transaction if the contract has already continued for many years. In particular, royalties for know-how can come under such scrutiny. Again the most effective focus for defence is often in providing tangible evidence of the existence of the know-how through patents and registrations.

Finally, benchmarking analyses are also often subject to scrutiny, with the ITO either performing its own benchmarking analysis or rejecting selected (high-margin) comparables in the taxpayer's benchmarking study. Adjustments based on single-year data are frequently imposed, although the regulations indicate that multiple-year data should be used.

Dispute resolution

There are no important developments in dispute resolution, although the DGT is actively negotiating advance pricing agreements (APAs) and mutual agreement procedures (MAPs) with various jurisdictions, both within the region and outside.

Litigation

The knowledge and understanding of the tax court judges is increasing. However, one of the main complications with the litigation process is that it is very time-consuming. Having to attend ten or more hearings is the norm. The most commonly used strategy is to provide as much tangible evidence as possible to the judges.

In a number of TP-related cases, taxpayers have succeeded in convincing the judges that the pricing was correct. However, if the taxpayer successfully appeals its case in the tax court, the ITO now more often than not appeals to the Supreme Court, adding more time to the dispute resolution process.

Other relevant updates

There have been no other TP-related updates or notes from the DGT other than the CbC reporting in the past year. The Indonesian TP regulations are already quite extensive and cover various topics, such as technical guidance, audit instructions, MAPs, APAs and regulations on the master file, local file and CbC reporting. Hence, no further formal guidance on existing regulations is needed. However, if the DGT holds true to its intention to introduce exit taxes, or would want to introduce other issues, more regulations will be required.

Conclusion

The TP landscape has been evolving rapidly since the publication of the first TP regulations in 2010. It now seems that the ITO, DGT and taxpayers understand the importance of implementing correct TP policies and how to address many technical issues. The judiciary also seems to be coming along, and Indonesia is falling more closely in line with nations with more advanced TP practices. However, frequent tax audits and related issues still make Indonesia a complicated jurisdiction in which to operate.

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Before joining KPMG in Indonesia, he was with the KPMG global transfer pricing services group in Singapore for almost four years and in the Netherlands for more than one year. Before that, he was with the international tax group of another organisation in Amsterdam and Jakarta for more than 20 years in total.

Iwan has been involved with various projects such as TP documentation, planning and audit defence, as well as advance pricing agreement (APA) negotiations.

Examples of Iwan's relevant experience include: TP documentation and planning for all relevant industries; audit defence in TP disputes; supply chain transformation projects in the chemicals, fast-moving consumer goods (FMCG) and commodities sectors; and extensive experience with TP and tax issues of Japanese business groups, including several trading houses (sogo shosha).

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Additionally, Aaron has been involved in advanced pricing agreements (APA) and tax rulings with tax authorities. He has also participated in business reorganisation and global tax efficient supply chain management projects.

Before joining KPMG in Indonesia, Aaron worked in the TP and international tax division at another Big 4 organisation in the US and in Switzerland for close to eight years in total.

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In addition, Fachrur wrote an article titled 'Talking About Transfer Pricing in Indonesia' published by Tax Planning International Asia Pacific Focus, Bloomberg BNA.

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Update on Japanese transfer pricing 2018

Recent changes in the business environment and the financial situation of the Japanese government have affected the Japanese taxation environment and transfer pricing regulations, explain Jun Tanaka, Nobuhiro Tsunoda and Yosuke Suzaki of **KPMG in Japan**.

From the perspective of the taxation environment, especially with the substantial increase in the financial deficit and additional financial expenditure on the social security system due to a rapidly ageing society, it has become 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 for Japanese taxpayers, it is also expanding the taxation base by shifting the tax base from direct tax to indirect tax (i.e. raising the consumption tax rate).

In order to ensure and increase its tax revenue, the Japanese tax authorities are paying particular attention to whether taxpayers located in Japan are reporting reasonable taxable income in relation to their functions and risks, and whether there is any unreasonable outflow of income to overseas countries. As a result, transfer pricing (TP) remains a hot topic in Japan.

Changes to (or introduction of) local transfer pricing legislation

In order to solve international taxation issues including TP, the Japanese tax authorities have expressed the need to coordinate with other countries' tax authorities and have actually amended or newly introduced the related regulations reflecting the BEPS action items. At the core of these is the rule for TP documentation in relation to the BEPS Action Plan 13.

There was already a TP documentation rule in existence in Japan, but it was not contemporaneous. The new TP documentation rule, based on BEPS Action 13, was introduced from (the fiscal year starting on) April 1 2016. Under the new TP documentation rule, Japanese taxpayers are required to prepare and file TP documents – a master file and a country-by-country (CbC) report – in electronic format within one year from the fiscal year end of the parent company. They are also required to prepare a local file by the taxpayer's tax return filing date, beginning from the fiscal year starting at April 1 2017.

At the same time, the authorised OECD approach (AOA) TP documentation rule was introduced. Under the AOA, permanent establishments (PEs) located in Japan, or entities which have PEs outside of Japan, need to prepare a local file to cover internal transactions with PEs.

Release of new administrative guidance by local tax administration

In 2018, some new administrative guidance was disclosed in relation to the TP area. One of the major topics is remuneration for intra-group services.

In new guidance, for routine and support services with limited risks, a 5% mark-up on total costs can be assumed as arm's-length price, as long as certain terms and conditions are met.

BEPS-related developments

Transfer pricing documentation (Action 13)

The new Japanese TP documentation rule, which applied from FY2017, clarified that "a taxpayer engaged in either (1) controlled transactions whose total amounts for the previous business year was JPY5 billion ($44 million) or more, or (2) transactions of intangibles whose total amount for the previous year was JPY300 million or more with one foreign-related party, must prepare a local file by the deadline for the submission of its tax return". However, this threshold does not guarantee exemption from the local file requirement. Even if the above threshold is not met, taxpayers are supposed to submit their local file when the tax authority requests it during a tax audit. Therefore, regardless of whether the thresholds are met, it would be advisable for taxpayers to review and assess their TP risk for their overall foreign related-party transactions and prepare a local file.

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

As regards the transfer pricing method (TPM) in the local file, the transactional net margin method (TNMM) is the most popular TPM, involving simply testing the overseas subsidiaries' margin. However, it is important to review the profit allocation among related parties even if TNMM is used as the primary TPM.

Intangible assets (Action 8)

As a result of the shift in manufacturing and distribution functions from Japan to overseas, the volume of out-out transactions conducted completely outside of Japan is still at a high level. Consequently, tax auditing and tax assessments for such out-out transactions have strengthened. In particular, intangible transactions including royalties and services transactions are major target areas during the tax audit, reflecting the main points of BEPS Action Plans 8 to 10. For Japanese companies, many foreign related parties that receive any benefit from a Japanese parent's intangible assets and services are located in BRICs and 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 is one of the major characteristics of recent Japanese TP audits.

Also, in the outline of a tax reform plan released in 2017, it was announced that the concept of the 'commensurate with income' standard would be discussed with a view to being introduced into Japanese tax regulation in the near future. Therefore, Japanese taxpayers need to pay attention to the treatment of hard-to-value intangibles (HTVI) and the related remunerations for HTVI in Japan and other countries.

Developments in relation to country-by-country reporting

As noted above, master files and CbC files must be prepared and submitted to the Japanese tax authority from FY2017. Taxpayers are expected to be cautious as regards consistency of the information included in the master file, as the Japanese tax authority will try to check that items such as definitions of business models, value chain analyses, and

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intangible assets in the local file correspond with those in the master file and CbC report.

Transfer pricing compliance activities by local tax administration

It appears that 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 still at a high level – 169 in FY2016 (the year ending June 2017) – and the TP assessment amount increased to JPY62.7 billion, which represents an increase of 460% against the previous year.

This situation indicates that the large multinational companies have already been addressed, and these large companies have taken preventive measures – most commonly TP documentation and advance pricing agreements (APAs) – but that the small and medium-sized companies are still to take such measures and ensure they have the relevant TP documentation. Another reason for this situation is the change in TP and tax audit procedures. In Japan, TP audits were traditionally conducted separately from corporate tax audits and carried out by a specialised TP audit team in a regional tax bureau. However, as a result of the tax reform in FY 2011, from January 1 2013 transfer prices, in principle, have been audited as a part of the corporate tax audit. The corporate tax audit is conducted regularly, targeting not only large enterprises but also small and medium-sized companies. The increased number of target companies for TP audit will lead to an increase in the number of TP assessment cases and the resulting amounts involved in the TP assessments.

In addition to TP assessments, another major issue is that during regular tax audits, Japanese tax examiners often challenge small transaction amounts, viewing them as donations to foreign related parties. When, during the course of a tax audit, a tax examiner finds a transaction in which a taxpayer receives no remuneration or the tax assessment amount is minimal, the tax examiner may try to deem it a donation to the foreign related party. Similarly, some companies may be required to make voluntary tax adjustments. The 'Status of field audits for corporations engaging in overseas transactions' survey released by the NTA reported the number of tax assessment cases at 3,335 and the tax assessment amount at JPY236.6 billion (including TP assessments) in FY2016, which was substantially larger than the TP assessment amount in the statistics. In addition, since this statistic does not include any voluntary tax adjustments by taxpayers, the actual number of cases and the tax assessment amount resulting in double taxation in relation to controlled transactions with foreign related parties, will be considerably larger than those disclosed in the statistics by the Japanese tax authority. Considering these circumstances, Japanese taxpayers should certainly take advance measures, including as regards TP documentation, in order to minimise TP risk for related-party transactions.

Dispute resolution

In Japan, APAs are one of the popular options used to avoid potential TP risk and to enhance the predictability and transparency of taxation. Also, tax audits in Japan are carried out periodically, and include a high level of detail. There has been an increase in the number of taxpayers who consider filing an APA in order to minimise the burden of a tax audit in relation to TP aspects, to avoid TP risk, and to strengthen their compliance with regulations. Advance pricing agreements provide much benefit to taxpayers, and thus the number of APA cases is increasing. The NTA also recommends applying a bilateral APA as an effective way to improve predictability. In FY2016, the number of mutual agreement procedure (MAP) requests including APA applications was 162, and the number of cases closed was 171.

Additionally, the coverage of countries taking part in bilateral APAs has increased and has been diversified,

which is a recent characteristic of APAs/MAPs in Japan. As previously described, with increasing transactions with different countries, such as BRICs and other Asian countries, as well as the increasing number of TP assessment cases in relation to transactions with related parties located in such countries, the counter-party countries of the Japanese tax authorities at the competent authorities' negotiations has also become diversified. Although the US is the major counter-party country, 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, and Hong Kong has recently increased. Considering these increases in APAs, the Japanese tax authorities have enhanced their internal resources (e.g. the number of employees) and expanded their network with foreign countries. Also, the Japanese tax authorities have tried to gather information via information exchange schemes based on tax treaties. The number of tax information exchanges over the past few years has been about 300,000.

Other relevant updates

In the 2017 tax reform, the Japanese controlled foreign company (CFC) regime was extensively amended in light of the final report of Action 3 of the BEPS project (designing effective CFC rules). This indicates that the Japanese tax authority is still focused on the trend of shifting profits from Japan to overseas.

Conclusion

In Japan, taxation on international transactions has been enforced in recent years. In the area of TP, as a result of the newly introduced BEPS TP documentation and the sharing of tax information contained in the master files and CbC reports with related countries' tax authorities, it is even more important for taxpayers in Japan to understand the tax position of all their group companies, to check on potential TP risks, to ensure the consistency of their TP policy within the group and to prepare all the relevant files.

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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.

Recent tax reform to align with the OECD BEPS Action Plan

The National Assembly of Korea approved the 2017 Tax Reform Bill on December 5 2017, write Gil Won Kang, Sang Hoon Kim and Seung-Mok Baek of **KPMG**.

The 2017 tax reform included the BEPS Action Plan measures, such as Action 2 on neutralising the effects of hybrid mismatch arrangements and Action 4 on limiting base erosion via interest deductions and other financial payments. It also included supplementing Action 13 on re-examining transfer pricing documentation, which had already been discussed in the 2015 tax reform.

The recently introduced tax reforms are the efforts of the Korean government continuously aligning with the OECD BEPS Action Plan, although the law needs to be amended to reflect the full integrity of the OECD initiative.

Details regarding the abovementioned matters and other transfer pricing (TP) regulations in the 2017 tax reform are included in this article.

Recent milestones in Korean transfer pricing

Since the Law on the Coordination of International Taxation Adjustments (LCITA), which encompasses Korean TP regulations, was introduced in 1995, the LCITA has been updated in line with the revision of the OECD TP guidelines, which in turn are aligned with the global TP standards. Accordingly, Korea introduced a supplement to the transactional profit method and comparability analysis published in its 2012 tax reform following the OECD's release of the revised TP guidelines in 2010. Furthermore, the Korean government has introduced and amended legislation, shown in Table 1, in relation to the OECD BEPS discussion items.

New developments in the 2017 tax reform

As referenced above, the newly implemented laws reflect Actions 2, 4, and 13 of the OECD BEPS Action Plan. The Korean government introduced two new regulations concerning interest expenses under Article 15, which will take effect on January 1 2019:

- Exclusion of Interest Expenses Incurred in Hybrid Financial Instrument Transactions from Deductible Expenses: The payment of interest by a domestic corporation and discount amortisation in relation to a financial instrument (with the nature of both capital and liabilities) transaction with a foreign related party that is not taxed and, as such, is not included in the income of the counter party, in the counter party's jurisdiction, within the appropriate period, will be excluded from the deductible expenses and deemed disposed of as expenditure of income of the domestic company; and

Table 1

OECD BEPS Action Plan	Relevant development in Korea's regulations
Action 2 Neutralise the effects of hybrid mismatch arrangements	Exclusion of Interest Expenses Incurred in Hybrid Financial Instrument Transactions from Deductible Expenses: LCITA, Article 15-3, newly inserted on December 19 2017. Details included in the next section.
Action 3 Strengthen controlled foreign company rules	Sanctions Against Non-Compliance with the Obligation to Submit Data: LCITA, Article 12, amended on December 19 2017. The obligation to submit information on controlled foreign companies (CFCs) has been strengthened, and a new penalty of up to KRW 100 million ($88,000) of additional tax may be levied for failure to comply.
Action 4 Limit base erosion via interest deductions and other financial payments	Exclusion of Interest Expenses Exceeding Income from Deductible expenses: LCITA, Article 15-2, newly inserted on December 19 2017. Details included in the next section.
Action 5 Counter harmful tax practices more effectively, taking into account transparency and substance	Substance Over Form Principle Concerning International Transactions: LCITA, Article 2-2, amended on January 1 2010. A substance-over-form rule that allows the tax authority to re-characterise a related-party transaction based on its substance in which the tax burden of a company has been unjustly reduced.
Action 6 Prevent treaty abuse	New preamble, including BEPS treaty anti-abuse rule, and adoption of the principal purpose test to deny treaty benefits in inappropriate circumstances (signing of the Multilateral Instrument, June 7 2017).
Action 13 Re-examine transfer pricing documentation	Obligation to Submit Data on International Transactions: LCITA, Article 11, amended on December 19 2017. Implementation of master file, local file, and country-by-country reporting (CbCR) requirements (combined report of international transactions, or CRIT).
	Guidelines, etc for Assessing Administrative Fines: Enforcement of Decree of LCITA, Article 51, amended on February 13 2018. Special provisions on the application of penalty tax: LCITA, Article 13, amended on December 19 2017. Details included in the next section.

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

- Exclusion of Interest Expenses Exceeding Income from Deductible Expenses: The limitation of the deduction of net interest expenses in which the amount borrowed from a foreign affiliate exceeds 30% of the adjusted income amount. Any excess amount is excluded from the deductible expenses and deemed disposed of as expenditure of income of the borrowing company.

Moreover, the 2017 tax reform contains a supplement to enforce Action 13 by increasing the penalties for failure to comply with regulations concerning the combined report of international transactions (CRIT), and the 'special provisions on the application of penalty tax' which regulated TP documentation (contemporaneous documentation) before the CRIT was introduced. The amendments are as follows:

- Standards, etc. for the imposition of administrative fines: The existing regulation stipulated that if any part of the CRIT was not submitted or was only partially submitted and/or was falsely described, each report would be subject to a KRW 10 million ($8,900) penalty. The penalty has now been increased to KRW 30 million for each report; and
- Special provisions on the application of penalty tax: In the previous article, when and if the taxpayer maintains and provides data verifying the method for an arm's-length

Table 2

OECD BEPS Action Plan	Relevant Korean regulations
Action 8: Intangibles	The Considerations for the Transfer Pricing Method for Intangibles: Enforcement Decree LCITA, Article 6, paragraph 2.
Action 9: Risks and capital	Selection of Transfer Pricing Method and "Supplement, etc. to the Transfer Pricing Method: Enforcement Decree of LCITA, Article 5, 6. Stipulates the comparability analysis that includes the risks accompanying trade.
Action 10: Other high-risk transactions	Arm's-length price for service transactions: Enforcement Decree of LCITA , Article 6-2. Stipulates the type of services transaction and the relevant criteria, which include the preparation of relevant documentation, such as a contract, organisation charts, and so on, for the deductibility of the service fees, which are paid by the Korea-based company to foreign related parties in other jurisdictions.

price applied in filing his/her income tax or corporate tax return and is acknowledged as having selected and applied the method for an arm's-length price based on a reasonable determination, the taxpayer was exempted from the penalty for under-reporting under a Korean tax authority assessment following filing of the tax return. In the amended regulation, the local file is regarded as the contemporaneous documentation when the local file is submitted within the deadline.

Not only did the Korean government introduce and amend regulations reflecting the OECD BEPS Action Plan, they also supplemented the 'Pre-Adjustment of Arm's-Length Price for National Taxes and Customs Duties' (LCITA, Article 6–3) and 'Rectification Claim for Adjustment of Arm's-Length Transfer Prices for National Taxes and Customs Duties' (LCITA, Article 10-2). Under the law before the amendments, taxpayers could file for pre-adjustment only if the TP method and the valuation method for customs duties were similar. However, under the newly amended law, taxpayers can now file for pre-adjustment even if the methods applied are not similar. Additionally, when and if there are differences between the import price and the price determined by customs authority, the period during which the taxpayer can file a claim after being made aware of the rectification has been extended from two months to three months.

Continuing discussion concerning Actions 8 to 10

Although Korean tax rules have no formal connection to the OECD guidelines, Korea has been diligently changing TP rules and administrative practice to align with the OECD guidelines. For example, the LCITA was amended in 2012 in accordance with the revisions made in the OECD guidelines published in 2010. Furthermore, Korea presented the 2017 tax reform in line with the 2017 OECD guidelines, which followed the final report on the OECD BEPS Action Plan published in October 2015. However, Actions 8, 9, and 10 are yet to be fully reflected in the LCITA.

As summarised in Table 2, Korea has followed the OECD guidelines when they were revised, but recent changes to the OECD guidelines have not yet been fully implemented in the LCITA. For example, the 2017 revised OECD guidelines include a section on analysing risk and necessary conditions for the assumption of risk, such as control of the risk and financial capacity and low value-adding intra group services, etc., but the LCITA has not yet introduced such concepts. Considering that recent TP audits in Korea involving management service fees have been under intense scrutiny by the tax authorities and the tendency for sufficient evidential documentation being required to prove the substantiality of the costs incurred by service providers, implementing low value-adding services in the LCITA would make it easier for multinational enterprises (MNEs) in Korea to analyse what documentation was required.

To its great credit, Korea has created the BEPS Support Centre. The centre was founded on March 2 2016 by the Ministry of Strategy and Finance, the Korean Institute of Public Finance, the Korean Chamber of Commerce and Industry, along with non-governmental experts. Gil-Won in KPMG in Korea was invited as one of those non-governmental experts, and has been participating as a core member of the centre. The BEPS Support Centre is aware of taxpayers' difficulties, especially as regards intangible transactions, in determining and verifying to the tax authorities that their TP outcomes are in line with value creation. Korea is proactively discussing how to reflect Actions 8 to 10 in the LCITA. Since Korea has always adopted any revisions to the OECD guidelines, it is expected that relevant regulations in relation to Actions 8 to 10 will be implemented shortly.

Conclusion

Korea has been examining its TP arrangements in line with revised OECD guidelines, but there is still some work to do in terms of formalising their legal status. It is unlikely that Korea would consider reflecting the changes in the OECD guidelines with immediate effect, yet more aggressive actions are expected in the near future.

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New government – transfer pricing as usual?

The Pakatan Harapan coalition formed a new government in May 2018 after defeating the Barisan Nasional coalition that had ruled the country for more than six decades, write Bob Kee and Mei Seen Chang of **KPMG**. This major shift in the political landscape of Malaysia is affecting the economic and business environment.

Following the change in the Malaysian government, many new policies and reforms have been initiated and more are expected to be announced in the near future.

To highlight a few of the changes, effective June 1 2018, the standard rate of tax for the goods and service tax (GST) was reduced from 6% to 0%. The GST will eventually be abolished from September 2018 onwards and the new government will be introducing the sales and services tax (SST) regime. The abolishment of GST will reduce the government's tax collections and thus it is expected that the government will focus its efforts on combating tax leakages through increased tax audits. It will continue to clamp down on structures that have elements of aggressive tax planning and transactions which lack commercial substance. Penalties for non-compliance are expected to be imposed at rates of up to 100% of the additional tax payable. Clearly, a strong message that non-compliance will be very painful!

This article discusses the various transfer pricing (TP) compliance measures that the Malaysian Inland Revenue Board (MIRB) uses to assist in its audit activities.

Various transfer pricing compliance measures in Malaysia

Country-by-country reporting (CbCR)

The Malaysian government is committed to joining in the efforts along with other jurisdictions in eliminating tax mismatches, increasing the level of transparency with tax authorities and creating a consistent global tax platform. This is evidenced by the MIRB's efforts to implement BEPS Action 13 in Malaysia.

The final rules for CbCR were first released in December 2016 and were subsequently amended in December 2017. The amended CbCR rules, which entered into effect on January 1 2017, apply to Malaysian-parented multinational corporation (MNC) groups with total consolidated group revenue of at least MYR 3 billion ($738 million) in the financial year (FY) preceding the reporting FY. The information submission mandated by the rules is in the form of the country-by-country (CbC) report to be submitted to the Director General of the MIRB on or before 12 months from the last day of the reporting financial year. The content of the Malaysian CbC report is as per the OECD's recommendation. Taxpayers who are obliged under the CbCR rules to prepare a CbC report are also required to prepare a master file and submit it together with the TP documentation when requested by the MIRB,

Table 1

	Salient changes
Chapter II: The arm's-length principle	• The application of the arm's-length principle will now focus on achieving TP outcomes that are in line with value creation; and • A risk analysis framework has been introduced to emphasise the interaction between risks and rewards. It sets out the process of analysing risks in a controlled transaction.
Chapter VII: Intangibles	• This chapter has been revamped with detailed guidance on identification of intangibles and the categories of intangibles; and • The chapter focuses on economic ownership of intangibles and analysing the entitlement of the arm's-length return based on the development, enhancement, maintenance, protection and exploitation of intangibles (DEMPE) concept.
Chapter X: Commodity transactions	• This is a new chapter introduced into the TPG. It provides taxpayers with guidance on the application of the comparable uncontrolled price (CUP) method on commodity transactions.
Chapter XI: Documentation	• Guidance is provided to enhance the quality of the TP documentation prepared by the taxpayer. It sets out the details of what needs to be covered in TP documentation; and • Master file requirements have now been inserted into this chapter (largely, the list of information is consistent with the master file's documentation requirement suggested by the OECD).

bearing in mind that taxpayers are typically given only 30 days to submit the TP documentation.

Enhanced transfer pricing guidelines

Following the release of the CbCR rules, the MIRB had also taken steps to tighten TP compliance in Malaysia by updating its 2012 transfer pricing guidelines (TPG). The updated TPG contain many enhanced requirements and have a substantial impact on how businesses are expected to manage and document their controlled transactions. A summary of the changes/enhancements to the TPG is set out in Table 1.

We understand that the MIRB is still in the midst of updating other chapters in its TPG. This is essentially to realign Malaysian TP requirements with those proposed under BEPS Actions 8 to 10 and Action 13.

Submission of transfer pricing information

Over the past six months, there appears to have been an increase in the number of taxpayers receiving Form MNE [1/2017]. This form was first introduced by the MIRB in 2011 to collect certain information from selected taxpayers relating to their cross-border transactions for TP risk assessment purposes. Selected taxpayers would receive a letter with the attached form and were required to complete and submit the form within 30 days from the date of the letter.

Form MNE (1/2017) is comprehensive and includes a wide coverage of key information to be collected from the selected taxpayers, including amounts transacted with related parties both inside and outside Malaysia.

In brief, the existing Form MNE (1/2017) requires the taxpayer to disclose the following information:

- A list of affiliates operating in countries having a lower tax rate than Malaysia with which the taxpayer has carried out transactions (if any);
- Details of business restructurings (if any have been carried out during the past five years);
- Details relating to research and development (R&D) activities carried out by the taxpayer (if any);
- Details relating to financial assistance received by taxpayers from related parties;
- Name of the company and country if the group or any of its related parties has any trade/brand name or IP or are performing R&D activities; and
- Particulars of transactions with related companies (both domestic and cross-border transactions).

As can be seen above, some of the information required may not necessarily be readily available locally, but would require support from taxpayers' headquarters. Further, most of the information sought through the form also seems to be part of the requirements under CbCR and the enhanced TPG. Taxpayers will need to exercise due care in completing Form MNE. Inaccurate disclosure of information may attract questions by the MIRB and result in taxpayers being considered as high risk for TP purposes when, in fact, that may not be the case.

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Transfer pricing audits and recent updates

Reports in local media have indicated that the MIRB had launched an operation called 'Mega Operation', involving 23 tax departments, 12 state tax offices, 37 tax branches, 17 tax investigation branches and a total of 4,219 of its 11,000 strong workforce in the country. This Mega Operation (the largest Malaysian tax audit operation to date), which was concluded in early December 2017, signifies the MIRB's commitment in closing tax loopholes and ensuring the tax compliance of the taxpayers.

Notably, during the Mega Operation, the MIRB performed tax audits on 15 banks (both local and foreign) in Malaysia that had offshore dealings, particularly with related parties in Labuan, as the tax authority is of the view that there is an unequal distribution of profits between financial institutions (FIs) in Peninsular Malaysia and Labuan, mainly driven by the different tax regimes in the two jurisdictions.

In the past, there was little focus on TP matters when tax audits were carried out on FIs by the MIRB. However, this has changed and the FIs must now pay attention to their TP policies as the MIRB is looking into FIs' compliance with TP rules and regulations.

To add to this, the Central Bank of Malaysia (Bank Negara Malaysia – BNM) is also scrutinising the inter-company charges paid by all licensed commercial, Islamic and investment banks and licensed insurers and Takaful operators to their foreign shareholders/related entities. The external auditors of the licensed FIs are required by BNM to validate and certify the inter-company charges paid. Bank Negara Malaysia expects the boards of the licensed FIs to critically scrutinise, validate and approve the inter-company charges. This involvement of BNM in scrutinising the inter-company charges paid by the licensed FIs mean that FIs must ensure they are able to justify the arm's-length nature of their inter-company payments.

In summary

The new government is focusing on the 'rule of law'. Transfer pricing requirements will continue to evolve in the coming years, as the authorities in Malaysia, whether the MIRB or BNM, will be stepping up their enforcement efforts to reduce non-compliance. Businesses can expect greater challenges by the authorities and if they are not well prepared or there is inadequate documentation, there will likely be some repercussions.

NZ BEPS monster on the horizon

The New Zealand transfer pricing landscape has changed rapidly over the past year, explain Kim Jarrett, Kyle Finnerty and Nadia Fediaeva of **KPMG**. With new BEPS legislation enacted, increased tax enforcement efforts, the Inland Revenue restructuring and a new government promising an increase in spending on tax enforcement, what more could happen in a year?

BEPS legislation to be enacted

In May 2018, after over a year of proposals, submissions and consultations, a revised BEPS Bill was reported back to New Zealand Parliament. The revised BEPS Bill includes changes to New Zealand's TP, permanent establishment (PE) and thin capitalisation rules.

The new rules seek to align New Zealand with the prevailing position of many global tax authorities in relation to the ongoing BEPS developments; but they also go further, adopting many of the rules recently introduced in Australia such as re-characterisation and PE avoidance.

KPMG professionals expect increased disputes between taxpayers and Inland Revenue stemming from the new rules. It would therefore be prudent for multinationals operating in New Zealand to ensure that they have worked through the implications of the rules for their TP operating models as soon as possible.

The May 2018 version of the Bill was enacted on June 27 2018. It applies to income years commencing on or after July 1 2018.

The key points of the new rules are discussed below.

Transfer pricing

The new rules are intended to strengthen New Zealand's TP legislation as outlined below.

The introduction of a TP re-characterisation rule is aimed at commercially irrational arrangements that would not be entered into by third parties. Like the PE avoidance rule, New Zealand follows Australia in introducing such a rule. Unlike the Australian rule, arrangements can only be re-characterised in exceptional circumstances.

The onus of proof for TP disputes will shift from Inland Revenue to the taxpayer. KPMG professionals anticipate that this shift will create substantial challenges for taxpayers in the dispute resolution process. This change is less surprising given it aligns with the approach taken by many other OECD countries (including Australia) and has long been signalled by Inland Revenue as a likely change to the TP rules.

The decision to shift the TP 'statute bar' to seven years (from the existing four years) has been justified by Inland Revenue on the basis that TP issues can take longer to investigate (and other countries, notably Canada and Australia, having similar time frames).

The rules codify the OECD TP guidelines as the basis for applying the TP rules in accordance with New Zealand tax legislation. In the past, New Zealand has generally used the OECD TP guidelines as a guide for

determining the TP of taxpayers, but the codification makes this an official position and requirement for taxpayers to follow in preparing their analyses.

New administrative rules increase Inland Revenue's 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 administrative rules also give Inland Revenue the power to require New Zealand taxpayers and offshore companies that are controlled by a New Zealand taxpayer to provide any requested information or documents. The new administrative rules will allow the commissioner to penalise or impute an uncooperative large multinational enterprise's (MNE) tax liability based on information it holds.

Throughout the proposal process for the new rules, Inland Revenue and the government considered policies such as contemporaneous documentation and a diverted profits tax. These policies were not considered necessary at this juncture because, in the mind of Inland Revenue, most multinationals are compliant with New Zealand's TP rules and therefore Inland Revenue did not want to levy an excessive burden on everyone. However, Inland Revenue and the government stopped short of dismissing these concepts altogether saying that they would adopt a 'wait and see' approach. The waiting period might not take long with a continuing tax working group review in New Zealand considering ways to improve the country's tax policies, and diverted profits tax being one policy embraced by the new Labour government during the election campaign.

All in all, the TP changes are meant to equip Inland Revenue with more extensive powers when it comes to TP disputes. The best defence for taxpayers is to ensure that they have robust TP documentation in place to support the positions taken.

Interest deductibility and thin capitalisation

The changes to the related party financing rules under the BEPS Bill are complex and may result in significant adverse tax consequences for many New Zealand entities holding cross-border related party debt. The new rules focus on limiting the interest rate charged on substantial cross-border loans for New Zealand borrowers that are considered a 'high BEPS risk'. From initial analyses undertaken, KPMG professionals have observed substantial discrepancies between an acceptable interest rate under the new rules and the arm's-length principle.

The new rules are extremely complex. Below is a summary of how they will take effect:

- The rules apply to related-party debt inbound to New Zealand that has an aggregate principal greater than NZ$10 million ($6.7 million);
- Optionally the terms of significant local third-party debt can be used to determine the credit rating for the purposes of the related-party debt analysis;
- Borrowers who are considered insuring or lending entities will have their credit rating made equal to that of the highest indebted member of the global group for the purposes of the TP analysis;
- Two tests are applied to consider whether New Zealand borrowers are high or low BEPS risk. Where an entity is a high BEPS risk, its credit rating is subject to a capping mechanism. Where it is a low BEPS risk, it can determine its own standalone credit rating under the arm's-length principle; and
- Exotic terms or features of applicable related-party debt are also disregarded for the purposes of pricing a related-party loan where those terms are not present in the multinational group's third-party borrowing. This includes capping the length of an inter-company loan for pricing purposes to five years.

The implementation of these new interest limitation rules makes New Zealand unique around the world. The standard approach for interest rate benchmarking focuses on the creditworthiness of the borrower whereas under the limitation rules certain instances base the analysis wholly on the creditworthiness of the multinational group. Initial calculations done by KPMG professionals are yielding substantially lower allowable interest deductions for many New Zealand members of multinational groups as compared to the approach using the arm's-length principle.

It is expected that Inland Revenue will ramp up its enforcement efforts in the area of inter-company financing once these rules come into effect. This will likely lead to more cross-border disputes between the acceptable rate under New Zealand law and the acceptable rate based on an application of the arm's-length principle. Ultimately this is creating more uncertainty and risk for New Zealand taxpayers.

The BEPS Bill also includes changes to New Zealand's standard thin capitalisation rules by now requiring an adjustment to assets in the calculations so that they are net-off against non-debt liabilities. The change to net rather than gross assets has the potential to shift the thin capitalisation 'safe harbour' more substantially and create much less predictably. Its effect will vary compared to the existing 60% safe harbour, depending on the role and size of non-debt liabilities held by the entity. 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. Many of the preliminary thin capitalisation calculations that have been prepared under the new rules are demonstrating this expected limiting outcome to be a harsh reality.

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Permanent establishment

The new rules largely aim to prevent large multinationals, i.e. those with global turnover greater than €750 million from avoiding a New Zealand PE by using a New Zealand related party to support local sales activities. The rules 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 that are more than preparatory or ancillary;
- There is an existing double tax agreement (DTA) applicable to the arrangement that does not include the OECD's new definition of PE;
- Some or all of the sales are not attributed to a New Zealand PE;
- The arrangement is designed or has an effect of defeating the intention of New Zealand's DTAs; and
- The purpose of the arrangement is more than merely incidental.

The changes will result in the taxation of both the deemed PE's profits as well as potential withholding tax on the PE's payments that are considered to have a New Zealand source.

Where the activities by the related New Zealand entity are carried out remotely (e.g. online from offshore), these activities are exempt from consideration as being carried out in New Zealand for the purposes of the deemed PE rules.

This PE 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 that should be taxed in New Zealand, rather than sales to consumers in New Zealand.

Where sales are attributed to a New Zealand PE, TP concepts will be required to allocate the correct level of income and expenditure to this PE.

Implementing the multilateral instrument (MLI) in New Zealand

The government signed the Multilateral Instrument (MLI) on June 8 2017 and further signed the DTAs (Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting) Order 2018 on May 14 2018. The MLI was incorporated into New Zealand domestic law on June 14 2018 and now needs to be deposited with the OECD in order for it to become effective – an effective status is achieved three months from the deposit date. In addition to the requirement of being deposited with the OECD, the counterparty jurisdictions to the MLI will also need to undertake similar steps before there are enforceable, two-way agreements in place across New Zealand's DTA network.

Release of new administrative guidance by Inland Revenue

In late 2017, Inland Revenue announced a change to its administrative policy mark-up for low value-added intra-group services. The new policy is to allow a mark-up on costs of 5% on qualifying services and align the rules with the OECD TP guidelines. This is a change from Inland Revenue's existing

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administrative policy for non-core services being a mark-up of 7.5%. This administrative policy is for income years beginning on or after July 1 2018. Where the administrative policy is not applied, benchmarking would be needed to support the mark-up on services, consistent with existing TP rules.

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

Despite Inland Revenue's previous position that no legislation was necessary to require country-by-country reporting (CbCR) for New Zealand members of multinationals in New Zealand, specific reporting requirements have been formalised in the BEPS Bill. The new CbCR requirements are consistent with the OECD recommendations in applying to corporate groups headquartered in New Zealand with consolidated group revenues of more than €750 million. Approximately 20 multinational groups headquartered in New Zealand are impacted by the requirements.

There are no local filing requirements in New Zealand for subsidiaries of foreign headquartered multinationals aside from local notification being made to Inland Revenue on request.

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

Inland Revenue's business transformation programme is focused on improving and streamlining the income tax compliance process in New Zealand, with the final, fourth stage of the programme due to be completed in 2021. As part of this transformation, Inland Revenue teams are meant to become leaner with the overall workforce expected to reduce by 25% to 30%. This reorganisation process commenced in early 2018.

Meanwhile, the new Labour government has earmarked in the 2018 budget additional funding for Inland Revenue's tax enforcement efforts. While there has been no specific increase in resourcing to date, Inland Revenue now has access to a range of risk assessment tools to better identify and target TP matters such as the basic compliance package and international questionnaire. These risk assessment tools have been supplemented with greater access to information from foreign tax authorities under wider information sharing powers and the first wave of country-by-country reports being shared between tax authorities. This is expected to lead to a higher volume of Inland Revenue dispute activity which spells trouble for taxpayers when coupled with the additional power being allotted to Inland Revenue through the BEPS Bill.

KPMG professionals continue to observe a number of instances where Inland Revenue appears to be following on closely from the audit activity being undertaken by the Australian Taxation Office (ATO) and these are leading to lengthy disputes. 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 PE avoidance, or insufficient compensation for New Zealand value-adding functions).

Conclusion

The past 12 months has been a period of transition with extensive consultations on the new BEPS rules, reorganisation at Inland Revenue and a new Labour-led coalition government in New Zealand. The next 12 months should see a continued incidence of lengthy TP disputes, driven by a more focused risk assessment approach in conjunction with greater information sharing between overseas tax authorities and new TP rules. This will lead to a much greater need for multinationals to consider the unique aspects of New Zealand TP. Multinationals are well advised to consider any immediate impacts of the BEPS Bill and ensure that their documentation and pricing models are sufficiently robust and detailed in order to navigate this increased complexity.

Still at a standstill?

Transfer pricing is on the radar again in the Philippines, reports Maria Carmela Peralta of **KPMG**. It's too early to tell whether the lengthy discussions taking place will bear fruit and the Philippines will have something other to show than its 2013 TP regulations, which the Philippine Bureau of Internal Revenue (BIR) is perceived to have overlooked.

Proposed anti-avoidance measures

After the first package of his tax reforms became effective on January 1 2018, the Philippine President had the second package – House Bill (HB) 7214 – filed with the lower house of Congress early in 2018. While the main focus of HB 7214 appears to be reducing the corporate income tax rate and removing redundant and costly incentives, it also makes reference to transfer pricing (TP). In its explanatory note, HB 7214 recognises that the Philippines' tax laws are outdated and lack adequate provisions to address TP and other tax avoidance practices that have led to an erosion in revenues.

However, the amendments introduced by HB 7214 in this regard are in the form of an anti-avoidance rule. Under the proposed amendments, in cases where a transaction or arrangement that directly or indirectly has tax avoidance as its purpose or effect, and if the tax avoidance purpose or effect is not merely incidental, the commissioner of Internal Revenue is authorised to disregard and consider such a transaction or arrangement as void for income tax purposes.

Moreover, the commissioner of Internal Revenue may adjust the taxable income of a person affected by the arrangement in a way he thinks appropriate in order to counteract a tax advantage obtained by the person from or under the arrangement.

The term 'tax avoidance' includes:

- Directly or indirectly altering the incidence of any income tax;
- Directly or indirectly relieving a person from liability to pay income tax or from a potential or prospective liability to future income tax; and
- Directly or indirectly avoiding, postponing, or reducing any liability to income tax or any potential or prospective liability to future income tax.

Further, under HB 7214, there is deemed to be tax avoidance in the above instances where the transaction or arrangement is motivated by obtaining a tax benefit or advantage with no commercial reality or economic effect, and the use of the provisions of the taxation law on such a transaction or arrangement would not have been the intention of the law.

At the time of writing, Congress has not had any deliberations on the proposed anti-avoidance measure. However, the Philippine government has made pronouncements to have the second package approved by Congress in 2018 and made effective in the first quarter of 2019. In fact, HB 7214 states that it will be effective on January 1 2019.

Note also that the amendment may not be treated as self-executing and may require implementing revenue regulations. Questions will also be raised on the effect of the action by the commissioner of Internal Revenue to consider the transaction or arrangement as void for income tax purposes. Notwithstanding his action, it would seem that the transaction or arrangement is still valid from a legal perspective.

BIR's 2018 priority programme

Once again TP is part of the BIR's priority programme for calendar year 2018. Specifically, in its Revenue Memorandum Circular 6-2018, dated December 18 2017, the BIR included, as one of its priority programmes, intensified audit investigations and collection of right taxes through joint and coordinated examination pertaining to BEPS and TP. This brings to mind the BIR's practice of conducting joint audits of conglomerates. However, the question is, to what extent the joint audits will be conducted. It is likely also that such joint audits will be the regular type of audits. This is because, to date, the BIR has not issued any guidelines for the conducting of TP audits.

Other developments: PFRS 15

Another development that may affect TP is the Philippine Financial Reporting Standards (PFRS) 15, which deals with revenue from contracts with customers. PFRS 15 will be the new revenue recognition standard effective in the Philippines for annual periods beginning on or after January 1 2018. PFRS 15 changes the amount of consideration, and the amount and timing of revenue to be recognised.

However, the BIR has not yet given any indication on how it views PFRS 15 and if PFRS 15 will determine the tax reporting. It is expected, though, that existing tax rules on reporting income and expenses will still prevail. Taxpayers should then have the supporting schedules for the differences in tax reporting.

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Hence, for purposes of preparing TP documentation, taxpayers may have to take into account the impact of PFRS 15 in calculating their profit level indicators. They may have to provide write-ups on the calculations in the documentation.

Conclusion

It is advisable for taxpayers to look at the substance of their contractual arrangements and evaluate if their agreements have a *bona fide* business purpose. The underlying agreements should be executed and readily available for submission to the BIR if requested. In light of the document-driven audits of the BIR, taxpayers should have supporting schedules for their tax reporting.

On the BIR's part, there should be recognition of the taxpayers' need to have clarity or guidance via revenue regulations or other circulars, especially after the approval by Congress of new laws. Implementation of the rules is also crucial. In the absence of such guidance and implementation, the Philippines may lag behind its Asia Pacific neighbours with respect to TP. It may even be at a standstill.

Fine-tuning the legislation for greater compliance

Singapore has been increasing its focus on transfer pricing, explain Geoffrey K Soh, Felicia Chia and Jingyi Lee of **KPMG**, with yearly revisions of the TP guidelines as well as the adoption of country-by-country reporting requirements. Recently, there has been a greater-than-ever push to ensure that taxpayers' profitability is consistent with the economic activities conducted and value generated.

A snapshot of recent changes

As part of its increased focus, Singapore introduced expanded TP legislation under the Singapore Income Tax Act (SITA) in October 2017. Accompanying subsidiary legislation (the Rules) and the fifth edition of the TP guidelines (TPG5) were also released in February 2018. While contemporaneous TP documentation has been required in Singapore since 2015, the requirement is formally legislated and corresponding penalties are introduced for non-compliance. The Rules provided additional detail (e.g. requisite content) on the documentation requirements, and the TPG5 was substantially expanded from previous editions for alignment with the SITA and Rules, as well as to provide administrative guidance to taxpayers.

Legislated requirements for TP documentation, surcharges on TP adjustments and specific TP penalties have been introduced to foster adherence and sound TP practices. Together with the power to re-characterise transactions, Singapore has become one of the stricter countries globally on TP enforcement.

Expanded Singapore legislation on transfer pricing

In October 2017, legislative requirements concerning TP were strengthened and expanded in section 34 of the SITA. These were followed in February 2018 by the introduction of the Income Tax (Transfer Pricing Documentation) Rules 2018 (rules), which are effective from the year of assessment (YA) 2019, along with the TPG5.

Some of the important developments contained within the expanded section 34 of the SITA are summarised below:

- Arm's-length principle – The expanded legislation continues to endorse the arm's-length principle as the standard to guide related-party transactions and elaborated on the ways by which the tax authority is able to make adjustments;
- Re-characterisation – In a new subsection added to the legislation, the tax authority provided the power to disregard the form of related-party dealings, if it is inconsistent with substance and lacks commercial rationality. Related-party transactions can be re-characterised to those consistent with arm's-length dealings, and taxed accordingly;
- Surcharge – A 5% surcharge on the amount of TP adjustments made (rather than the tax arising from the adjustment) by the Inland Revenue Authority of Singapore (IRAS) is introduced from YA 2019. This means that the surcharge will be payable regardless of whether the taxpayer is in a tax paying position; and

- Transfer pricing documentation – A new section to the SITA formalises the existing requirement for taxpayers to maintain contemporaneous TP documentation. From YA 2019, unless certain exemptions are met, taxpayers are required to prepare and maintain TP documentation for each related-party transaction. Such documentation must be prepared no later than the filing due date and must contain items specified in the Rules. Failure to comply with this and various other provisions for documentation to be considered timely and complete may attract a fine not exceeding SG$10,000 ($7,000).

The rules provide additional guidance on the form and content of TP documentation, as well as specific situations where there may be an exemption from preparing the documentation. There are some noteworthy items in the Rules, as follows:

- The documentation must contain the information specified in the second schedule of the Rules. The information requirements under the Rules have some consistencies with the OECD master file and local file requirements under BEPS Action 13, albeit not identical. The Rules substantially expand the information requirements in new areas such as changes to group structure as well as more granular details for many items;
- The completion date of documentation must be specified, thereby reinforcing the contemporaneous requirement;
- Various exemption criteria under which detailed TP documentation is not required are provided under the Rules. The exemption applies to small operations with gross revenue of less than SG$10 million ($7.3 million), related-party transaction volumes that do not exceed low-value thresholds, situations where the risk of tax revenue leakage is relatively small, and/or in situations where a safe harbour can be applied; and
- The introduction of simplified TP documentation whereby qualifying past TP documentation prepared in the preceding financial year(s) could be used for the present financial year attached with a declaration.

The use of the qualifying past TP documentation is subject to the fulfilment of the following criteria:

- Past TP documentation was prepared in accordance with the latest legislation, Rules and TPG5, and must contain specific information required therein;
- Past TP documentation is properly dated and prepared in English;
- The transaction documented in the past TP documentation is the same as the transaction in the present year;
- The transaction documented in the past TP documentation was undertaken with the same related parties; and
- The following information contained in the past TP documentation remains relevant in the present year:
  - Commercial or financial relations between the taxpayers and their related parties;
  - Conditions made or imposed between the taxpayers and their related parties;
  - TP method applied for the transaction; and
  - Arm's-length conditions within the meaning of section 34, including comparability with the conditions/circumstances observed between independent parties.

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Geoff has managed more than 2,000 international engagements, encompassing the compliance, planning, audit defence, and dispute resolution aspects of TP. He has helped clients in transactions relating to transfer of products, risks, services, intellectual property, funds, and guarantees. In addition, he has led a number of advance pricing agreements (APAs) involving tax authorities from Asia, Europe, and the Americas.

Under his leadership, KPMG in Singapore was also recognised as the Singapore Transfer Pricing Firm of Year 2018 and appeared in the World Transfer Pricing Guide for 2018. His viewpoints and articles on TP issues can be found in industry publications such as CCH, *International Tax Review*, and accounting industry publications in Canada and Singapore.

Guidance for alignment with the expanded legislation and rules

The key changes in TPG5 seek to align the guidance with the expanded section 34 and the recently introduced Rules, as well as to provide additional clarity on the legislative changes through illustrative examples. In addition, through the TPG5, the IRAS has also provided further clarification on its position in the following areas:

- TP for permanent establishments (PE) is aligned with the authorised OECD approach to attributing profits to a PE as separate and independent enterprises;
- Singapore taxpayers may still have access to the mutual agreement procedure (MAP) when a settlement has been

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Felicia's experience includes advising on TP planning and documentation projects to determine proper arm's-length compensation for tangible property, intangibles, and inter-company 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 TP risk analyses. She has also been involved in the negotiation and implementation of unilateral and bilateral advanced pricing agreements (APAs) and mutual agreement procedures (MAPs). Felicia has also led several value chain management projects and advised clients on how to comply with OECD BEPS guidance.

Felicia is a regular speaker on global TP and has published a number of articles in connection with TP issues. She was recognised as a leading adviser in Singapore in the inaugural 2015, 2016 and 2017 editions of *International Tax Review*'s Women in Tax Leaders guide.

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reached with a foreign tax authority. However, resolution would be challenging under such circumstances;

- The transactional profit split method should not be applied where the contribution of at least one party to the transaction can reliably be evaluated through another TP method; and
- Re-financing arrangements should be considered as new loans and the terms and interest rates should be determined based on the arm's-length considerations at the time of the re-financing arrangement.

What the changes in the SITA, the Rules and TPG5 really mean to taxpayers

Incorporating the concept of arm's-length conditions represents a substantial shift in how the Singapore tax authority might evaluate and enforce the arm's-length principle in practice. In the past, the form and structure of related-party transactions have been mostly accepted at face value with the key TP focus area being the pricing itself.

Going forward, the IRAS might apply a more holistic perspective and seek to understand the commercial purpose of each transaction. The foregoing might be particularly relevant for financing arrangements, as well as complex supply chain structures for commercial businesses.

With the various legislative changes and substantial revisions to the TP guidance, it is now more important than ever that taxpayers proactively prepare contemporaneous TP documentation, giving due consideration to the commerciality of their related-party transactions.

The introduction of qualifying past TP documentation may relieve taxpayers' burden to prepare documentation on a yearly basis. However, given the potential importance of surcharge applicable on the TP adjustments made by the Singapore tax authority, it is even more crucial for taxpayers to ensure that these documents are sufficient and robust to support the TP outcomes and profitability of taxpayers.

There has been increased scrutiny on taxpayers' related-party transactions as well as an increase in the number

of disputes observed in the past few years, and it is expected that this trend will continue. More in-depth and stringent TP audits by the Singapore tax authority are anticipated. The Singapore tax authority has also communicated that it is closely monitoring taxpayers' TP compliance efforts as well as regional and international developments in this space. It is expected the TPG5 will be revised on a periodic basis as a response to these developments, and the next edition of the guidelines is expected in early 2019.

Head start for new developments

Transfer pricing rules were introduced in Sri Lanka in 2006 and became enforceable from 2008, writes Shamila Jayasekara of **KPMG**. The revenue authorities did not administratively enforce the rules, giving time for taxpayers to conform to requirements.

Release of new administrative guidance by the local tax administration

Tax rulings are issued by the revenue authorities from time to time, providing administrative guidance on issues raised by taxpayers. 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 taxpayers 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, under the new Income Tax Law, the revenue authorities are required to make public all rulings, unless specifically requested by taxpayers.

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

BEPS-related developments

The government has not initiated a policy decision to implement the BEPS Action Plan, except for Action 13. With the tax reforms in progress via the adoption of a new income tax law, it has been intimated that double tax agreements (DTAs) would be revised. It is not clear at this stage whether the proposed revisions would entail the implementation of the BEPS Action Plan.

Developments in relation to country-by-country reporting

The revenue authorities have intimated their intentions to implement the three-tiered documentation approach under Action 13, but the relevant regulations are yet to be issued. However, as intimated by the revenue authorities, these regulations would be issued with retroactive effect from April 2018.

Transfer pricing compliance activities by local tax administration

The TP unit within the Inland Revenue Department was formed in 2015 and officers have been trained by the Indian tax authorities and the OECD.

Certification relating to international transactions was submitted to the revenue authorities for the first time in 2015. Revenue authorities have now commenced carrying out TP audits, focusing on companies that have recorded tax losses in relation to this year.

The regulations require that any TP audit on international transactions should be routed via a TP 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

The local law provides for a company to enter into unilateral or bilateral advance pricing agreements (APAs). However, no APAs have so far been concluded by the revenue authorities and they have stated 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 TP audit within five years from the end of the relevant year of assessment. Since enforcement of TP is new to Sri Lanka, the revenue authorities have not raised many assessments and are in the process of conducting audits and collating information.

Certificates and disclosures filed for the year of assessment 2015 to 2016 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 upon and be influenced by precedent case law in India.

Conclusion

Revenue authorities have now commenced auditing international transactions and prescribed documentation. Hence, it is advisable for multinational enterprises (MNEs) to be compliant with local TP requirements and be able to justify pricing. Further, domestic groups also are required to be prepared with documentation.

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Stepping in line with global trends

To align with international tax trends, Taiwan's Ministry of Finance (MoF) announced amendments on November 13 2017 to existing transfer pricing assessment regulations, write Sherry Chang, Karl Chan and Anita Lin of **KPMG**.

The new amendments apply to the fiscal years of 2017 onwards. In line with BEPS Action 13, the three-tiered transfer pricing (TP) documentation is composed of a TP report (local file), which had already been implemented under existing TP assessment regulations since 2005, and two new additions – country-by-country reporting (CbCR) and the master file (MF).

Country-by-country reporting

Threshold and content

A Taiwanese constituent entity of a multinational profit-seeking enterprise (MNE) with preceding annual consolidated group revenue of more than NT$27 billion ($879 million) is required to submit a country-by-country (CbC) report no later than 12 months after the last day of the reporting fiscal year. The CbCR must be carried out in both Chinese and English. In relation to annual consolidated group revenue, the consolidated financial statements of the ultimate parent company (UPE) of the group must be used.

The CbC report should disclose aggregate information relating to the amount of revenue, profit (loss) before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees, and tangible assets other than cash or cash equivalents, with regard to each jurisdiction in which the MNE group operates. The reporting MNE should determine the nature of the main business activity carried out by the constituent entity in the relevant tax jurisdictions. The disclosure information is not substantially different from that mentioned in the guidelines recommended in BEPS Action 13.

Notification and submission requirements

When filing the income tax return, a Taiwanese constituent entity of an MNE must disclose relevant information, such as details of the UPE or the surrogate entity (SPE) appointed by the MNE that is responsible for carrying out CbCR in Taiwan. Furthermore, if a Taiwanese entity of an MNE is not required to carry out CbCR in Taiwan, it will be obliged to disclose whether the MNE is subject to CbCR in other jurisdictions.

Where an entity in Taiwan is the UPE of an MNE with a preceding annual consolidated group revenue of more than NT$27 billion, it is compulsory for that entity to prepare a CbC report for the reporting fiscal year and submit the CbC report to the Taiwan tax authority. However, where an MNE's UPE is located outside of Taiwan, its

Taiwanese constituent entities must submit the CbC report to the Taiwan tax authority if one of the following conditions apply:

- The UPE of the MNE is not obliged to file a CbC report in its jurisdiction;
- The UPE has filed a CbC report in its jurisdiction, but that jurisdiction does not have an agreement to exchange CbC reports with Taiwan by the time of the CbCR deadline in Taiwan; or
- The UPE has filed a CbC report in its jurisdiction and that jurisdiction has an agreement to exchange CbC reports with Taiwan, but the Taiwan tax authority is unable to effectively obtain the CbC report in accordance with the agreement.

According to an announcement regarding the list of exchange countries issued by the MoF on April 27 2018, the Taiwan tax authority so far can only obtain CbC reports through a related agreement from New Zealand. The list will be updated from time to time.

Master file

Threshold and content

Under the legislation amendment, if a Taiwanese entity of an MNE meets either one of the following conditions, it will be exempted from filing an MF in Taiwan:

1) The Taiwanese entity's total annual turnover of the present year (include operating and non-operating) does not exceed NT$3 billion; or
2) The total amount of all cross-border controlled transactions for the present year do not exceed NT$1.5 billion.

The MF must contain details of the group organisational structure, the group business, group intangibles, group inter-company financial transactions and group financial and tax positions. This is similar to the guidelines recommended by the OECD in BEPS Action 13.

Notification and submission requirements

When filing annual income tax returns, it is mandatory for a Taiwanese constituent entity of an MNE to disclose relevant information, such as, whether the Taiwanese entity of the MNE meets the relevant threshold and whether any other entities of the MNE are required to file an MF in their jurisdictions. If there are more than two entities in Taiwan, the MNE can designate one of the Taiwanese entities to file the MF. In addition, the MF must be filed in Chinese and submitted to the tax authority within 12 months after the last day of the reporting fiscal year. If an MF is submitted in a foreign language, a Chinese translation must also be attached. If an Ms is submitted in English, the taxpayer may submit a Chinese translation within one month upon receiving a written request to do so from the Taiwan tax authority (this extension can only be granted once and cannot exceed one month).

New income tax guidelines on cross-border electronic services

Due to the rapid development of the internet and the increase in electronic commerce, on January 2 2018, the MoF issued a new ruling with respect to the income derived by foreign profit-seeking enterprises (PSEs) from the cross-border sales of electronic services to domestic buyers in Taiwan (including individuals, profit-seeking enterprises, organisations and entities). The ruling applies retroactively from January 1 2017.

Definition of electronic services

Under Article 4-1 of the Enforcement Rules of Value-added and Non-value-added Business Tax Act, the term 'electronic services' is defined as services that are provided by being downloaded through the internet and stored on computers or mobile devices for use; or that are provided online without being downloaded and stored in devices. It also applies to other services are provided through the internet or through other electronic tools.

Models and types of cross-border electronic services

There are two major business models for cross-border electronic services under the new ruling. One business model refers to cross-border electronic services conducted with an online platform similar to foreign PSEs, such as Amazon, Apple, Google, etc., which establish online platforms on the internet. These would include online virtual stores for both domestic and overseas buyers and for sellers to conduct service transactions by means of the internet or other electronic means.

The other business model is for those conducting services other than through an online platform, in other words foreign PSEs rendering cross-border electronic services to buyers through websites established by foreign PSEs, such as online games, e-books, online music, online advertising or cloud storage and computing, and so on.

Determination of Taiwan-sourced income

In accordance with the amended principle for determining Taiwan-sourced income under Article 8 of the Taiwan Income Tax Act, income from cross-border electronic services would be deemed Taiwan-sourced if there was a substantial economic connection to Taiwan. Hence, the following examples demonstrate how remuneration received by a foreign PSE may or may not be deemed Taiwan-sourced income:

- Digital products produced in totality outside of Taiwan by means of the internet or other electronic means, for domestic buyers to download and store on computers or mobile devices, and with only their display being different. These might include standalone software or e-books, and therefore, remuneration for this service would not be

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He has also participated as a speaker at TP seminars hosted by KPMG in Taiwan, the Taiwan tax authorities, and various foreign trade organisations.

recognised as Taiwan-sourced income. Nevertheless, if such cross-border electronic services were carried out with the assistance or participation of domestic individuals or corporations, they would be deemed as generating Taiwan-sourced income;

- Services provided via the internet or through other electronic means which are instantaneous, interactive, convenient, and continuous. These might include, for example, online games, online drama, online music, online videos, or internet advertising. In this case, remuneration received from aforesaid services rendered to domestic buyers would be considered Taiwan-sourced income;
- Services provided through the internet or other electronic means by an enterprise with a physical place of business, whether or not via foreign online platform operators. If those services were rendered outside of Taiwan or the business was being operated outside of Taiwan, the service charges would be deemed non-Taiwan-sourced income; and
- Services provided through an online platform where sellers and buyers conduct transactions and where one of the transacting parties was a domestic individual, PSE or organisation – remuneration received via these kinds of services would be considered Taiwan-sourced income.

Computation of taxable income

Once remuneration is determined as Taiwan-sourced income, the taxable income would be calculated by deduction of relevant costs and expenses and application of the relevant domestic profit contribution ratio as described below.

Deduction of relevant costs and expenses

If supporting accounting books or relevant documents can be provided, foreign cross-border electronic service providers can claim actual costs and expenses incurred for the calculation of taxable income. If accounting books and relevant documents are unavailable, foreign PSEs can apply for a pre-approval for the deemed net profit ratio, which is 30%.

Applicable domestic profit contribution ratio

For cross-border electronic services that are carried out both within and outside of Taiwan, only the income attributed to the profits within Taiwan is considered as Taiwan-sourced income. Hence, foreign PSEs could apply for a pre-approval for the applicable domestic profit contribution ratio.

Payment of income tax and obligations

Foreign PSEs having neither a fixed place of business nor business agents in Taiwan, who provide cross-border electronic

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Lin has a wide range of TP experience, having been involved in advising on TP planning, preparing contemporaneous documentation and assisting in tax audits for multinational corporations operating in the information, communication and financial services sectors. In addition, Lin spent a secondment in KPMG in Singapore's TP practice where she engaged in a variety of international TP projects.

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services to domestic individual buyers and obtain non-withholding income in accordance with Article 88 of the Income Tax Act, must file tax returns during the income tax declaration period as stipulated in the Income Tax Act, or engage a business agent to do so on their behalf.

However, if foreign PSEs with no fixed place of business or business agent within Taiwan derive Taiwan-sourced income from selling electronic services to domestic business buyers, the domestic business buyers within Taiwan must withhold the taxes from each gross payment to foreign enterprises and pay the taxes to the tax authorities in accordance with Articles 88 and 92 of the Income Tax Act.

Foreign PSEs deriving Taiwan-sourced income from selling electronic services to domestic business buyers, who have obtained advance approval for the applicable net profit ratio and the onshore profit contribution ratio from the Taiwan Tax authorities, may calculate their income based on the applicable net profit ratio and the onshore profit contribution ratio within Taiwan, and the net income will be subject to a 20% withholding rate at the date of payment. Where a 20% withholding tax is imposed on gross revenue, foreign PSEs may apply (or engage an agent to apply on their behalf) to the Taiwan tax authorities for approval to re-calculate income via the applicable profit ratio and the onshore profit contribution ratio. They must apply within five years from the withholding tax payment date for a refund of overpaid tax. Meanwhile, Taiwan has signed comprehensive double taxation agreements with 32 countries. Foreign PSEs that are selling electronic services to domestic business buyers may be eligible for tax relief under one of these tax treaties, if applicable. In such cases, the foreign PSE or the tax withholder in Taiwan may claim a refund of tax overpaid to the tax authority within five years from the withholding tax payment date.

Recent tax reform in Taiwan

Amendments to the Income Tax Act were passed on January 18 2018 and became effective from January 1 2018. The amendments aim to close the gap of the income tax burden, and achieve a competitive and fair income tax system.

Under the amendments to the Income Tax Act, the corporation income tax rate has increased from 17% to 20%, and the surtax rate on undistributed profits has been reduced from 10% to 5%. Meanwhile, in order to address the complexities resulting from the existing imputation tax system, the imputation system was officially abolished from January 1 2018.

For non-resident shareholders, including individuals and corporations, tax is withheld at source on dividends distributed by a resident company in Taiwan and the withholding tax rate on dividend income has increased from 20% to 21%. However, this might be reduced under relevant tax treaties. As for individual residents, individual investors can choose to combine or separate dividend income from other individual income, using whichever of the following options that provides a more beneficial outcome for them when receiving dividend income. Meanwhile, the highest rate of individual income tax will be reduced from 45% to 40%:

- Option 1: Tax the dividend income combined with other individual income – 8.5% of the dividend income can be deductible and the maximum allowable deductible amount is NT$80,000 per taxpayer; or
- Option 2: Dividend income is taxed separately from any other individual income, with the dividend income being taxed at a flat rate of 28% instead of at the individual income tax rate.

Thai transfer pricing law to be enacted in 2018

It has been more than three years since the framework of the transfer pricing law was first drafted and approved by the Cabinet of Thailand in May 2015, write Benjamas Kullakattimas, Abhisit Pinmaneekul and Chollatip Santitorn of **KPMG**.

In June 2017, a public hearing on the draft of the transfer pricing (TP) law was conducted by the Thai Revenue Department (TRD). Of the total participants, 90% agreed that the TP law should create transparency, reduce the transfer of profits among multinational enterprises (MNEs), and prevent double non-taxation. In January 2018, the Cabinet approved the draft TP law, which will amend the Revenue Code on TP. This draft TP law provides descriptions of related parties, minimum income threshold, requirements on TP disclosure form submission, and TP documentation preparation, and provides for a non-compliance penalty (which is limited to THB 200,000 ($6,000)).

Finally, the wait is almost over. As the Cabinet submitted the draft of the law amending the Revenue Code on TP to the National Legislative Assembly for approval on June 5 2018, there is an expectation that the law should be enacted within 2018.

Updates on the upcoming transfer pricing legislation (including regulations)

The draft TP law submitted to the National Legislative Assembly contains some updates since the previous version, which are as follows:

- The first applicable accounting period has been revised from on or after January 1 2017, to on or after January 1 2019; and
- A taxpayer who passes the minimum income threshold of THB 30 million will still be required to disclose its relationship with related parties and the amount of its related-party transactions in its annual tax return submission, regardless of whether the taxpayer's relationship with its related parties extended throughout the entire accounting period.

Upon the enactment of the TP legislation in Thailand, the TRD is expected to subsequently propose secondary legislation to the Cabinet as regards the following:

Ministerial regulation on the calculation of revenue and expenses of a related entity or related juristic partnership, whereby the framework will cover:

- Definition of 'related entity or related juristic partnership', 'controlled transaction', 'uncontrolled transaction', 'transaction condition', and 'advance pricing arrangement' (APA);
- Consideration of the arm's-length principle;
- Comparability analysis;
- Calculation/determination of arm's-length range;
- Tax assessment through the adjustment of revenue and expenses;

- Consideration of conditions for special transactions, e.g. intangible transactions;
- The request for APAs;
- Ministerial Regulation on the determination of the revenue base of an entity or partnership that is not subject to the TP disclosures (Section 71 ter). The framework will cover the determination of revenue base, as well as categories of excluded income, for the purpose of exempting a company or juristic partnership from the annual TP disclosures and/or TP documentation;
- Notification of the director-general of the TRD providing details of a TP disclosure form, which will need to be submitted together with an annual tax return filing under Section 69; and
- Notification of the director-general of the TRD providing the requirements for the preparation and submission of documents or evidence in order to perform an analysis of related-party transactions. This will include the requirement for a company or juristic partnership to disclose information and prepare documents/evidence as specified under this notification.

The tentative timeline is for both ministerial regulations to be proposed to the Cabinet within 60 days after the law is enacted, and for both notifications of the Director-General of the TRD to be announced within 30 days after both ministerial regulations are introduced.

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Her TP experience includes assistance in preparing and reviewing TP documentation and providing advice on the Thai tax and TP implications of transactions, including the transfer of tangible and intangible property, inter-company services and cost-sharing arrangements. She has also provided assistance on advanced pricing agreements (APA), audit examinations and negotiations with tax authorities.

Benjamas frequently presents on topical Thai taxation issues for KPMG in Thailand and at public seminars. She also contributes articles to various publications and lectures on tax at various universities in Thailand.

BEPS-related developments

BEPS Action Plan 5 – harmful tax practices

The Cabinet agreed to participate in the OECD's BEPS inclusive framework. In this context, the TRD has been reviewing its tax regimes provided for investment promotion (i.e. international headquarters, regional operating headquarters, international trading centre, treasury centre and international banking facility).

On June 19 2018, the Cabinet issued a draft Royal Decree to add further requirements for international headquarters in relation to royalty income. The proposed change is that royalty income qualifying for the reduced corporate income tax of 10% for onshore income and tax exemption for offshore income will be limited to royalties derived as a result of research and development activities performed in Thailand by the international headquarters (internally or outsourced).

The international banking facility incentive was completely abolished.

BEPS Action Plan 1 – digital economy

The second draft of the e-commerce legislative amendments was released on January 17 2018. It proposed that a foreign company providing services through electronic media to a non-VAT registered person, provided the services were used in Thailand, must register and would be subject to 7% VAT in Thailand if its annual taxable income exceeded THB 1.8 million.

Related BEPS Action 7, on artificial permanent establishments (PEs), is still being considered by the TRD.

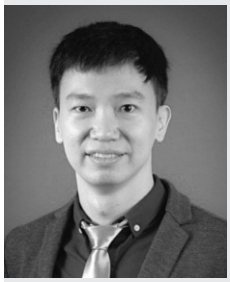
Developments in relation to country-by-country reporting (including local file and master file)

The TRD has been considering BEPS Action Plan 13. It is understood that the working team is contemplating whether the country-by-country reporting deadline should be aligned with the deadline for the filing of the annual tax return for that income year, or whether it should be delayed by 12 months. The merits of allowing an extension for the submission deadline in the first year of filing are also being assessed.

Transfer pricing compliance activities by local tax administration

We have seen an increase in TP audits and investigations conducted by the Thai tax authorities. Our key observations are:

- The TRD has increased its workforce for conducting TP audits. General tax audit teams across Thailand are now also carrying out investigations, in addition to the specialised TP audit team. Generally, they request TP documentation for review as a starting point, but may also request other documents (i.e. agreements, details of TP policies with examples of pricing calculations, group foreign exchange



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Abhisit led technical sharing sessions in respect of the OECD TP guidelines and BEPS with the tax authorities. He is a frequent speaker at various TP events and seminars and a lecturer of a tax planning course at Chulalongkorn University.

policies, and so on). In some cases, tax authority officers may request that TP documentation is translated into Thai;

- Transfer pricing audits focus not only on manufacturing companies but also trading and services companies. For trading companies, tax audits increasingly target taxpayers that incur losses from the purchase of goods from related parties for resale to third-party customers. If a TP adjustment is made on the import prices, a portion of input VAT may be disallowed to be used for offsetting against output VAT. This would result in additional VAT liability plus a penalty and surcharge;
- Service transactions are still one of the top priorities for tax officers in conducting tax audits or reviews; and
- We have seen an increasing number of cases where the tax authorities request taxpayers to provide segmented financial data (i.e. board of investment [BOI] vs. non-BOI, related parties vs. third parties, and so on). Where a taxpayer requests a VAT refund, the tax authorities may request the taxpayer to provide monthly financial data that can be used to review and challenge monthly profitability.

Dispute resolution

The TRD is more open to bilateral APAs. In several TP audit cases, the TRD has suggested that taxpayers apply for bilateral APAs to manage TP risks going forward.

Other relevant updates

The TRD has started to focus on reviewing TP and PE issues in respect of e-commerce companies. Any interactions with the TRD must be carefully managed.

Conclusion

The draft TP law has reached the next important milestone in the legislative process. With the proposed enforcement date being on or after January 1 2019, it may be inferred that the law may be enacted within this year. With the tentative first filing of the TP disclosure form in May 2020, a pro-active approach to the preparation of robust TP analysis, documentation and anticipated required disclosures will be essential in managing TP risks, including discussions with the tax authorities on future proposed adjustments and reduced penalties.

Taxpayers with related-party dealings that pass the minimum income threshold of THB 30 million should prepare in advance to comply with the upcoming TP law. At a bare minimum, taxpayers should initially prepare information on their related-party transactions and their relationship with related parties for entry into a TP disclosure form. This will have to be submitted along with the annual tax return filing.

Although the TP disclosure form has not been released to the public yet, it is expected that the form will request information similar to that required in the TP questionnaire that is already being used by the TRD during TP audits and investigations.

The TP questionnaire requires taxpayers to provide the following:

- Details of related-party transactions in respect of purchases, sales, the provision of services, receipt of services, royalties, interest received and/or paid on loans;
- The name of related parties and countries in which they are located; and
- The value of the transactions and the currencies applied in each related-party transaction.

The reality of Decree 20

Vietnam's regulatory changes have required an increasing number of taxpayers having to be aware of the transfer pricing rules, explain Hoang Thuy Duong, Tran Thi Thuy Ha and Sandra Liston of **KPMG**. However, inconsistencies in the interpretation has led to substantial efforts by the tax authority to clarify the rules.

This past year predominantly focused on the implementation of Vietnam's Government Decree 20/2017/ND-CP of February 24 2017 (Decree 20) and Circular 41/2017/TT-BTC (Circular 41) dated April 28 2017, which were both applicable from May 1 2017. The regulatory changes have led more and more taxpayers to be aware of the transfer pricing (TP) rules, and enhanced compliance requirements for taxpayers in terms of documentation. Nevertheless, since this is the first year of implementing the new rules, there have been inconsistencies in the interpretation of the legislation. Hence, substantial efforts went into clarifying any ambiguous areas, including in relation to the deductibility of interest expenses, the safe harbour, and the new Form 01.

In addition, the anticipated increase in audit activity manifested itself in the form of numerous audit notices already being received by taxpayers in the first quarter of 2018. The audits so far have focused both on TP and tax audits in various industries, and the selected taxpayers have ranged from loss-making companies all the way to highly profitable companies. As the audit activity by the tax authorities is expected to further increase, it will be crucial to maintain adequate resources in order to properly deal with the specific cases at hand.

Law on Technology Transfer

The recent Law on Technology Transfer 07/2017/QH14 (LTT 2017) of June 19 2017 on the state management of technology transfer transactions was effective from July 1 2018 and also includes technology transfers concluded before July 1 2018 that were amended or extended. It should also be noted that the TP of the payments for inbound technology transfers is subject to a state audit.

In addition, the tax authorities during the audit and inspections process may request proof of registration of the technology agreements to evaluate the credibility of the royalties in order to assess corporate income tax (CIT), despite the fact that registration was not compulsory under the existing 2006 Law on Technology Transfer 80/2006/QH11 dated November 29 2006 (LTT 2006). More detailed information regarding LTT 2017 will be provided below.

Insights into the BEPS Action Plan

The adoption of the BEPS Action Plan in emerging markets and a developing economy like Vietnam may attract the tax authorities' attention regarding a plethora of issues. Businesses in Vietnam already have reviewed and

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Hoang Thuy Duong has been with the KPMG network of firms for almost 18 years, including with KPMG Australia for 15 months in the global transfer pricing services (GTPS) and corporate tax groups.

Duong has advised numerous multinationals on tax, customs and transfer pricing (TP) planning, compliance and dispute resolution, supply chain tax planning, business restructuring and has provided tax due diligence and structuring advice on a number of corporate transactions in various sectors including industrial, automotive, fast moving consumer goods (FMCGs), financial services, infrastructure, information technology, and the Japanese market.

Duong was the engagement partner of several dozens of TP audit and dispute resolution engagements where many of the cases were resolved successfully either in the audit, appellation or in one court case (the only court case on TP adjustment in Vietnam to date). Duong himself was invited to speak to the central and provincial fiscal and non-fiscal authorities on international best practices in TP audits and local practical issues.

Having been the engagement partner for a TP capacity building project with the General Department of Taxation (GDT), funded by the EC, Duong advised on the conclusion of Vietnam's first advance pricing agreement (APA) which is the only APA to have been concluded to date.

Duong provided advice to the General Department of Taxation and Ministry of Finance in relation to Decree 20/2017/ND-CP on TP management in line with BEPS Action 13, including the consideration of practical issues in local TP audits of multinational corporations operating in Vietnam.

should continue to review their policies based on a greater level of transparency and their internal risk assessment. Shared master files and, for the largest groups, the country-by-country (CbC) reports may potentially provide tax officials with insights that were previously denied to them in the vast majority of cases.

Specific issues that exist post-adoption of the BEPS Action Plan are as follows:

- Income tax deductibility:
  - In Vietnam and from an 'inbound' perspective, income tax deductibility – particularly for inbound service charges from overseas affiliates – has been posing a greater challenge than the TP remuneration itself. For the local tax authorities, allowing a service fee deduction from both a technical and administrative perspective may not be easier than arguing the merits of the arm's-length nature of the transaction itself. The characterisation of the deduction is also critical, where a payment termed 'management fee' or 'service charge' may automatically be disallowed as a deduction;
- The interest expense deduction cap, whereby the interest payment is in excess of 20% of taxpayers' total operating profit plus interest and depreciation expenses in the tax year (earnings before interest, tax deductions, amortisation, or EBITDA).
  - This is a problem for a number of sectors and taxpayers depending on the phase of their enterprise's development, including group financing companies, holding companies infrastructure, and real estate companies that are highly leveraged and will not have positive EBITDA during the first few years of commercial operations; and
- Proof of benefits for payments of royalties, which will be discussed further below.

Vietnam already signed up to be the 100th member of the BEPS inclusive framework, adopting the four minimum standards, and the observation is that the tax authorities have been open to the new BEPS measures on permanent establishment (PE) and the OECD guidance on attribution of profits to PEs.

Loss-making entities

Foreign-owned enterprises, which are loss-making entities in Vietnam and are paying royalties and service charges to parent entities (intangible holding companies) with an existing overall group profit, can give impetus to the tax authorities for critically examining the master file and the CbC report. These reviews may even happen before analysing the local file, benchmarking, underlying agreements and the system that produces TP figures for returns and accounts.

Given that there are unprecedented numbers of countries that see TP as a golden opportunity to raise tax revenues, the taxpayers in Vietnam may require elements of subjective and objective reasoning to arrive at a supportable position in all of their Action 13 documentation. Taxpayers' positions and approaches in the three-tiered documentation would be reviewed together, and it is not surprising that the scope for challenge and negotiation is seen as high by many jurisdictions, including Vietnam.

Provincial tax authorities increased scrutiny of inter-company transactions involving intangibles and intra-group services

Following the guidance in Decree 20 on TP management, particularly the specific rules for deductibility of inter-company charges between related parties, and the recent LTT 2017,

some of the provincial tax authorities have increased their focus on reviewing and challenging historical CIT deductions for royalties and service fee payments to related parties of Vietnamese taxpayers.

Specifically, the tax authorities have requested companies to provide details of expenses paid to related parties and relevant supporting documents, and self-assess and amend historical CIT returns to pay additional CIT in accordance with the rules provided under Decree 20.

Implementation dates of Decree 20 and LTT 2017 and substance-over-form principle

For the past few years, under Circular 117/2005/TT-BTC dated December 19 2005 (Circular 117) and Circular 66/2010/TT-BTC dated April 22 2010 of the Ministry of Finance (Circular 66), the plain vanilla arm's-length principle applies. From financial year 2017, with the implementation of Decree 20 and LTT 2017, the consideration of CIT deductions in respect of the payments are complicated given the new rules, such as the substance-over-form principle under Decree 20 and the legal requirements under LTT 2017.

Based on this principle, related-party transactions (RPTs) that are inconsistent with the arm's-length principle or do not provide direct economic benefits and add value to the business activities of taxpayers will be rejected.

For royalties, for example:

- Royalties that involve a payment made by a taxpayer to the recipient, where the taxpayer cannot show that the recipient has the rights over the economic assets and the power and ability to generate revenue through such ownership;
- Royalties where the taxpayer cannot demonstrate that a direct benefit was achieved from the payment of the fees to the related parties;
- Royalties paid to related parties with regard to a technology transfer where the taxpayer fails to prove the technology has in fact been transferred; and
- Royalties paid to related parties by a Vietnamese contract manufacturing subsidiary based on a percentage of net sales made to related parties.

For intra-group services, for example:

- Intra-group services that are seen as not providing the local taxpayer with direct economic or commercial value to enhance or maintain its business position;
- Intra-group services that benefit related parties' shareholders;
- Duplicative services that are provided by several related parties; and
- Services that provide benefits to the taxpayer because the taxpayer is an entity of the group.

As mentioned previously, in order to avoid rejection by the tax authorities, a documented functions, assets and risk profile of the related-party recipient should be maintained.

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Ha has advised a wide range of multinationals from the Australia, Europe, US, and Asia Pacific regions in diverse industries including consumer/industrial goods, media and entertainment, financial services, electronics, forwarding and logistics, and information technology, on tax, customs, and TP compliance and planning, and inbound investment.

Ha's sector experience includes TP, taxation, trade and customs.

Ha was the engagement director of several dozens of TP audit and dispute resolution engagements where many of the cases were resolved successfully either in the audit or appellation. She was invited to speak to the central and provincial tax authorities on international best practices in TP audits and local practical issues.

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

In addition, the benefit test can determine whether an independent party in comparable circumstances would have entered into the arrangement.

Supporting documentation is key

The new Law on Technology Transfer reinstates the statutory requirement of companies to register their technology transfer agreements with the relevant state body and, for the first time, enables an audit of the pricing of inbound technology transfers.

It is recommended that companies that have RPTs that involve intangibles or intra-group services review their transactions and prepare all necessary supporting documentation. The following measures may be considered to ensure defensive or proactive tax management in relation to the aforementioned transactions:

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Previously, she worked as a TP professional at KPMG in the US for seven years, and at KPMG in Germany for one year. During this time she assisted a variety of multinational clients in the US, Europe and Asia with TP services. The companies were primarily engaged in industrial products, commercial products and the provision of services.

Sandra now works with clients from Europe and the Middle East as well as Asian clients from countries including Japan, Korea, Taiwan and China.

Sandra's portfolio includes manufacturers in industries such as automotive, FNB, electronics, and chemicals, service providers including IT, engineering, logistics, and project management, as well as various trading entities.

- Review and ensure consistency among the master file, local file, and CbC report, as well as the statutory disclosures of the transactions in accordance with the guidance under Decree 20;
- Review of the companies' inter-company agreements supporting the payments for intangibles and/or intra-group services;
- Review and register technology transfer agreements with the relevant authorities;
- File and pay foreign contractor tax on the payments for intangibles or intra-group services;
- Seek subject matter expertise during audits or inspections conducted by the competent authorities, or when resolving disputes or controversies; and
- Apply for an advanced pricing agreement (APA) with the competent authority in respect of complex transactions to gain certainty on the tax treatment.

Transfer pricing audits doubled from 2016 to 2017

Notwithstanding the above focus on TP audits during the past 12 months, there has been a substantial increase in the number of TP audits conducted by the tax authorities on enterprises that have low profits or have had consecutive losses during past years. In 2016, 329 enterprises were audited on TP. In 2017, the number of audits increased to 700 enterprises and that number is expected to be even more in 2018. Non-tax authorities (e.g. the customs authority, or state auditor) have started to conduct (or will be involved in) TP audits, in addition to the tax authorities. For example, in certain cases, the customs authority is enquiring into TP matters in the post-clearance audit, or the state auditor may initiate the audit of royalty payments under the new Law on Technology Transfer. Based on the recently released targets for tax audit and inspections in 2018, the domestic revenue should be increased by 12% to 14% and the number of enterprises subject to tax audit and inspections should involve at least 18.5% of the total number of enterprises.

Given that an APA takes a long time to be completed and the mutual agreement procedure (MAP) has not been very productive so far, the most effective option for defending the taxpayer's TP position during a TP audit is to be compliant, responsive and cooperative with the tax authorities during the audit.

Prevailing landscape regarding the treatment of transfer pricing versus customs

Similar to other tax jurisdictions in the Asia-Pacific region, Vietnam does not have a formal recognition of the interdependency between a TP report or APA and a customs valuation. It continues to remain a bone of contention between businesses, customs and the tax authorities.

A transfer price adjustment may or may not be acceptable to customs authorities (depending on the net effect on customs duty collection). However, referring to TP studies and APAs for useful information regarding the valuation of goods is gaining momentum with the customs authorities. The developments regarding the APA regime could be a positive step towards mutual recognition between customs valuation and TP.

Both tax and customs authorities are realising the interdependency between TP and customs legislation. This recognition, albeit without a legal basis, is quickly gaining ground and is expected to become a norm in due course.

Taking stock of the insights gained throughout the year

This past year entailed adapting to a new environment. Not only were there challenges regarding the proper application of Decree 20, but also the volume of the deliverables increased substantially in size. Through proper communication with the tax authorities as well as the taxpayers, the preparation of the Forms 01, 02, 03 or 04, the preparation of the local file, and the review of the taxpayer's master file and CbC report a new status quo has gradually emerged.

As discussed already in detail, the large increase in TP audit activity in 2018 will likely over time become the new norm regarding TP work in Vietnam.

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