APRIL 2017 ISSUE 23
WWW.BDO.GLOBAL

TRANSFER PRICING NEWS

IRELAND
The EU state aid case against Apple
READ MORE 8

PUERTO RICO
Proposal of new transfer pricing regulations
READ MORE 12

SPAIN
Recent developments – the SII VAT system and potential impact on transfer pricing monitoring
READ MORE 14

INTRODUCTION

Transfer pricing is increasingly influencing significant changes in tax legislation around the world. This 23rd issue of BDO's Transfer Pricing Newsletter focuses on recent developments in the field of transfer pricing in Australia, Germany, India, Ireland, Malaysia, Puerto Rico and Spain. As you can read, major changes in legislation will be made and interesting developments occur as a result of the OECD BEPS project.

We are very pleased to bring you this issue of BDO's Transfer Pricing News, which we were able to produce in close co-operation with our colleagues from the above-mentioned countries. We trust that you will find it useful and informative. If you would like more information on any of the items featured, or would like to discuss their implications for your business, please contact the person named under the item(s). The material discussed in this newsletter is intended to provide general information only, and should not be acted upon without first obtaining professional advice tailored to your particular needs.

CONTENTS

AUSTRALIA

LATEST TRANSFER PRICING DEVELOPMENTS

Diverted profits tax legislation introduced into parliament

The Diverted Profits Tax (DPT) legislation has been formally introduced to the Australian Parliament. Substantially unchanged from the original proposal, the DPT legislation can potentially apply to any 'related party' transactions undertaken by a significant global entity (Global group revenue in excess of AUD 1 billion) between an Australian company and entities in a country with a company tax rate below 24% (for example, the United Kingdom).

Commencing on 1 July 2017, the DPT is a powerful tool for the Australian Taxation Office (ATO), with over 1,600 large multinational entities potentially within the scope of the colloquially termed 'Google tax'. Broadly the DPT is a special penalty tax rate of 40% applicable to transactions that the ATO deems to lack sufficient economic substance and divert Australian profits to offshore related parties in order to avoid paying tax in Australia. Critically, companies are required to settle their debt within 21 days once the Tax Commissioner has issued an amended assessment. The ATO will then have 12 months to review the decision, during which time the company can provide further evidence or documents to the ATO. The company cannot appeal the Commissioner's decision to the courts until after the 12 month period of review.

The primary change from the original proposal is the exclusion of managed investment trusts and similar foreign entities, foreign pension funds, and foreign sovereign wealth funds. Whilst the DPT was inspired by the United Kingdom's equivalent 'Google tax', the current legislation before Parliament has been criticised as draconian due the lack of protections and limitations when compared to the UK version. Furthermore, due to Australia's comparably high corporate tax rate, transactions with major Australian trading partners such as the United Kingdom, Hong Kong, Singapore, Switzerland and potentially the United States in the near future will all be covered under the DPT.

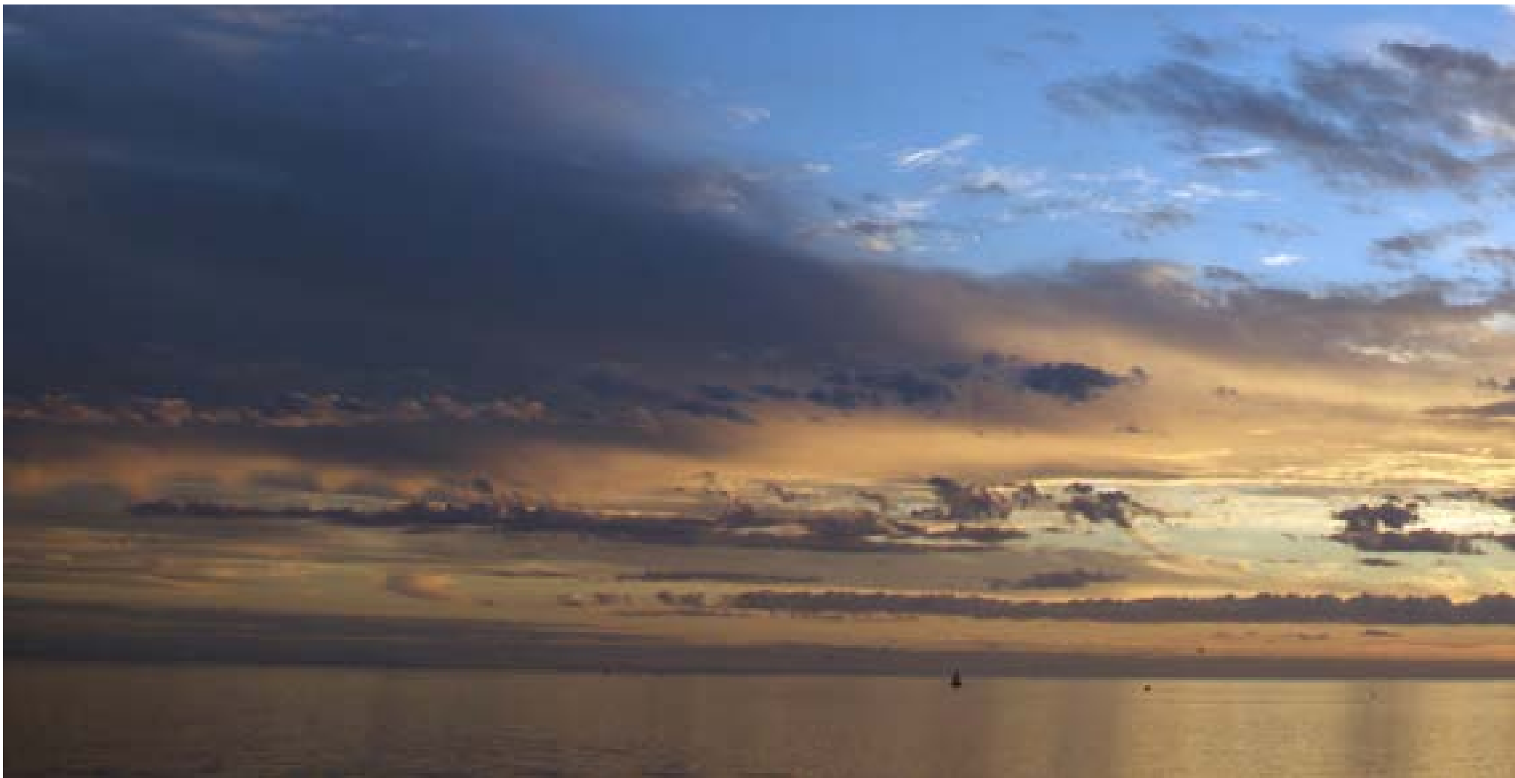
In addition to the DPT, the Government has also doubled the penalty for significant global entities making false or misleading statements and significantly increased the penalty for significant global entities who fail to lodge tax documents on time, with an administrative penalty of up to AUD 525,000 potentially payable by significant global entities that fail to comply with their tax reporting obligations.

The legislation also amends Australia's transfer pricing laws to give effect to the 2015 OECD transfer pricing recommendations, which provides greater clarity on how intellectual property and other intangibles should be priced and ensures the economic substance of the transaction is accurately reflected in any transfer pricing analysis.

ATO releases Sales and Marketing Hubs paper

The ATO has released a Practical Compliance Guideline that proposes groups with overseas marketing hubs self-assess and document their arrangements according to the ATO's new traffic light system approach. In order to achieve a 'green light', an entity's hub profit must not be more than 100% of the costs associated with that sales operation, as well as commercially realistic. Hence where groups do not have a significant presence offshore and have a handful of well-paid sales people, it may be very hard to achieve a green light.

Groups not achieving a green light will need to estimate the potential tax at stake and consider approaching the ATO for an Advanced Pricing Agreement (APA) to agree their current and past transfer pricing position for the hubs. If the group is outside the Green zone but below AUD 50 million tax impact it will be at a lower to medium priority for review by the ATO but if it has over AUD 50 million of tax at stake it will be rated as amber and have a higher priority for review. If the group fails to assess the tax at stake and put in place documentation or voluntarily and co-operatively engage with the ATO, the group will be rated as red. A red rating could potentially lead to continual audit or litigation. If the group is prepared to restructure arrangements to operate as a 'low risk' business, the ATO will offer a one year amnesty from penalties and interest to encourage compliance with the new regime.



Country-by-Country Reporting in Australia

For accounting periods starting on or after 1 January 2016, the Australian Government has introduced additional reporting requirements into subdivision 815-E of the Income Tax Assessment Act 1997 (Cth). The aim is to allow the Commissioner of Taxation to obtain relevant and reliable information to carry out a transfer pricing risk assessment. Under the new law, Significant Global Entities (SGEs), that is, Australian residents or foreign residents with an Australian Permanent Establishment (PE) having an annual global revenue of at least AUD 1 billion (for the worldwide consolidated accounting group), are required to provide a statement to the ATO. The statement comprises a Country-by-Country Report (CbCR), Master File and Local File. The three reports can either be lodged at the same time as the Income Tax Return for the income year or within 12 months after the end of the income year.

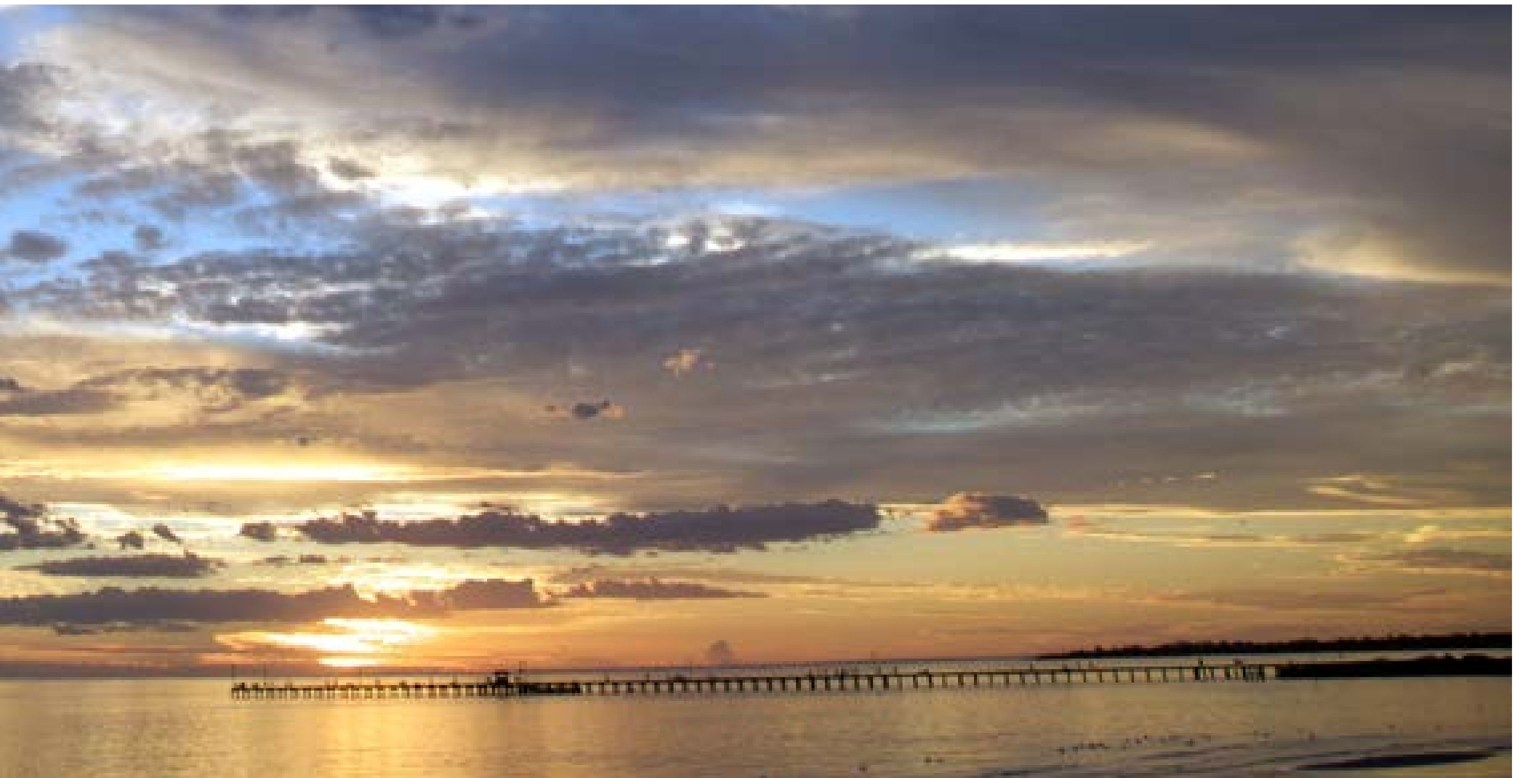
The CbCR is required to set out reporting of high-level information relating to the global allocation of a multinational group's income and taxes paid, as well as information about the location and main business of each constituent entity within the group. The Global Parent Entity of the global group is required to lodge the CbCR with their local tax office who will share it via specific software, an XML Schema, with the ATO. It is the responsibility of the Australian SGE to ensure that the Global Parent Entity prepares and lodges the CbCR in a timely manner.

The Master File briefly outlines the multinational group's business operations that will enable tax authorities to place the group's transfer pricing practices in their global economic, financial, legal and tax contexts. It includes information such as the group's organisational structure, its intangibles and intercompany financial activities, its financial positions and tax positions. The Master File can be prepared by any entity in the SGE global group. If prepared by an overseas entity in the SGE Group, the Australian SGE must ensure that the Master File is made available to Australia in a timely manner.

The Local File focuses on specific transactions between the reporting entity and their associated enterprises in other countries. It requires the identification of relevant related party transactions, the amounts involved in those transactions, and the entity's corresponding analysis of the transfer pricing determinations. While the contents of the Local File may overlap with Australian transfer pricing documentation, it is a separate and additional requirement in its own right. The Australian SGE is required to prepare the Local File within the required time frame. It must be electronically lodged via ATO approved channels in accordance with the XML schema. At this stage lodgement has not been enabled for these statements. Lodgement functionality is likely to be available from 1 July 2017.

Failure to comply with Country-by-Country requirements may entail penalties ranging between AUD 90,000 and AUD 450,000. The penalties are proposed to increase to a minimum of AUD 105,000 to a maximum of AUD 525,000. While the OECD guidance states that there are no exemptions from filing the CbCR, upon application, the Commissioner of Taxation may exempt an entity or a specified class of entities from providing a CbCR, Local File and/or Master File for a one-year period or more. This will however depend on the facts and circumstances of each particular case.

ZARA RITCHIE
MELBOURNE – Australia
zara.ritchie@bdo.com.au



GERMANY

NEW DEVELOPMENTS IN TRANSFER PRICING DOCUMENTATION

Aimed at countering aggressive tax planning, an action plan was published in the course of the BEPS project of the OECD/G20 in July 2013. This action plan includes 15 individual Actions. In the final report on Action 13 of the BEPS project, the OECD recommends a three-tiered approach to document intragroup transfer prices, incorporating a Master File, Local File and a Country-by-Country Report (CbCR)[1].

Following the recommendations of the OECD, the German legislator revised the regulations on the documentation of transfer prices as set forth in § 90 General Fiscal Code (*Abgabenordnung* – AO) and introduced further provisions by adopting the *Gesetz zur Umsetzung der Änderungen der EU-Amtshilferichtlinie und von weiteren Maßnahmen gegen Gewinnkürzungen und -verlagerungen* of 20 December 2016[2]. The Decree on the Documentation of Profit Allocation (*Gewinnabgrenzungsaufzeichnungsverordnung* – GAufzV) will be amended or adjusted in accordance with the recommendations of the OECD.

Effects of the new developments

Master and local file

Taxpayers who are part of a multinational group with total (unconsolidated and not limited to intragroup provision of goods and services) revenues of at least EUR 100 million in the prior fiscal year are, according to amended § 90 paragraph 3 AO, obliged to create an overview of the group's global business as well as the system used by the group to determine transfer prices. In its explanatory notes the legislator calls this document the 'Master File'. In accordance with the explanatory notes such document should, in particular, include a presentation of:

- The organisational structure;
- The group's global business;
- The overall strategy for the utilisation of intangible assets in the value chain; and
- A general description of group financing.

The amendments follow to a large extent the guidelines of the OECD. In addition, according to the OECD, the Master File should also contain information on existing unilateral Advance Pricing Agreements and other transfer pricing focused tax rulings relating to the allocation of income between countries. The preparation of the Master File is mandatory for business years starting after 31 December 2016.

The Local File is supposed to include significant detailed information on the individual transactions of a local entity and its related parties or permanent establishments (PEs) abroad. According to amended § 90 paragraph 3 AO, the country-specific, business-related documentation ('Local File') has to include information on the time of the determination of transfer prices in addition to the documentation of facts and the economic analysis that have to be prepared regardless of the EUR 100 million threshold. Subject to an amendment of the GAufzV, existing reduced documentation requirements for smaller enterprises remain in effect.

Upon request, both Master and Local File have to be submitted within a period of 60 days (30 days for extraordinary transactions), the previously applicable deadlines remaining unchanged. The amendments do not require the filing of the Master File and tax return at the same time, as originally intended. The Master File might, however, have to be submitted sooner in other countries. It is therefore recommended to check the deadlines applicable in all countries involved and prepare the Master File as soon as possible.

If a taxpayer did not submit documentation or submitted documentation that in essence can be regarded as insufficient, a reversed burden of proof would result and a penalty between a minimum of 5% and a maximum of 10% of the income adjustment must be raised (with a minimum of EUR 5,000) according to § 90 paragraph 3 AO. As this surcharge only applies to the income adjustment it will also be raised if the taxpayer does not have to pay a tax on income as a consequence of a loss carried forward.

If adequate transfer pricing documentation is not provided to the tax authorities within 60 days respectively (30 days for extraordinary transactions) after a request, the penalty amounts to at least EUR 100 for each full day beyond the deadline, up to a maximum of EUR 1,000,000 (see § 162 paragraph 4 AO).

[1] *OECD (2015), Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264241480-en.*

[2] *BGBl. 2016 I, 3000.*

Country-by-Country Report (CbCR)

If a domestic company has to prepare 'Ultimate Parent Entity' consolidated financial statements and if its annual consolidated group revenue equalled or exceeded EUR 750 million in the previous business year (§ 138a AO), such enterprise has to prepare a so-called CbCR.

The CbCR obliges companies with subsidiaries or PEs abroad to disclose relevant information per country, e.g. revenues, profit or loss in the course of ordinary activities, taxes paid or number of employees. In some circumstances, the responsibility to submit the CbCR can be delegated to a group entity ('Surrogate Parent Entity'). In addition, each domestic enterprise ('Constituent Entity') that is neither the Ultimate Parent Entity nor Surrogate Parent Entity is obliged to file a CbCR if the Federal Central Tax Office (*Bundeszentralamt für Steuern* – BZSt) does not receive a country-specific report from a foreign Ultimate Parent Entity. If the domestic company is unable to meet this request, it has to inform the BZSt and provide all information it can possibly obtain. The CbCR has to be prepared for the first time for business years beginning after 31 December 2015 and has to be submitted one year after the end of the business year, i.e. by 31 December 2017, at the latest.

To check if a domestic company meets its CbCR-related obligations, tax returns have to state whether the filing enterprise is a domestic Ultimate Parent Entity, a Surrogate Parent Entity or a domestic group company included in the consolidated financial statements of a foreign Ultimate Parent Entity.

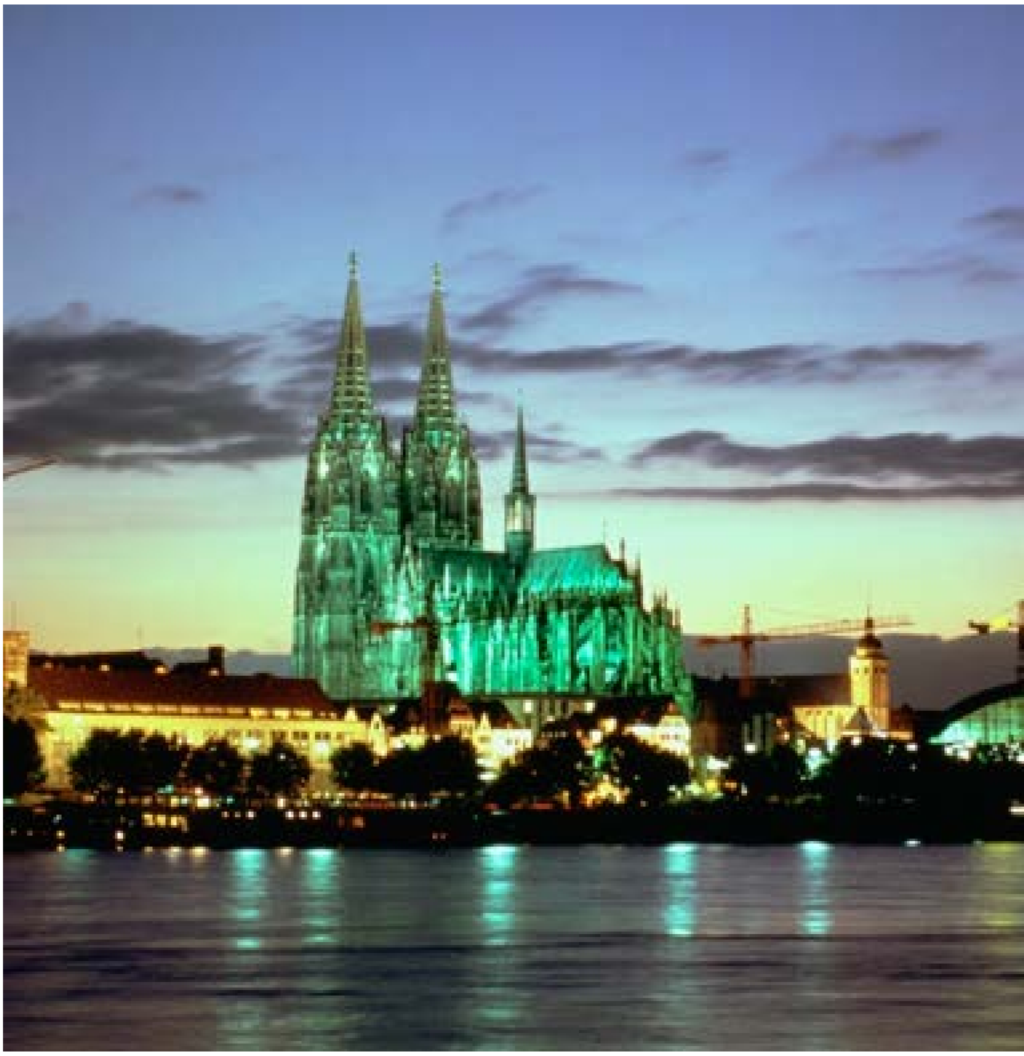
The CbCR has to be filed with the BZSt using the prescribed official data format. Information thereby collected will be stored for 15 years and automatically exchanged with foreign fiscal authorities. For this purpose, 50 countries (as at December 2016), including the Federal Republic of Germany, signed a corresponding treaty[3]. If necessary, this will enable a cross-border risk assessment of multiple assessment periods and traceability of developments over a longer period of time.

If the taxpayer does not meet its reporting obligations in accordance with § 138a AO fully/partly, or fails to do so in time (either intentionally or negligently), it commits an administrative offence. The penalty of up to EUR 10,000 can be directed at the enterprise or the (non-) acting persons.

Recommendations

It is recommended to have transfer pricing documentation in place in order to meet the new documentation requirements in Germany. Having documentation in place will avoid penalties and reduce the risk of double taxation. Furthermore, you will be in control of your intercompany transactions and tax position.

DIRK ELBERT
Frankfurt – Germany
dirk.elbert@bdo.de



[3] *Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports (CbC MCAA), https://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/cbc-mcaa.pdf.*

INDIA

BUDGET 2017

Indian Finance Minister, Mr. Arun Jaitley, tabled the Budget for the fiscal year 2017-18 (The Budget 2017) in the Parliament on 1 February 2017. The Budget 2017 presents forward-looking measures in so far as transfer pricing is concerned. Besides rationalisation of the application of transfer pricing provisions to certain categories of domestic related party transactions, it proposes introducing a secondary adjustment regime and limiting the deduction of interest in respect of overseas associated entities (AEs).

Rationalisation of domestic transfer pricing provisions

In 2012, more than a decade after introducing transfer pricing in the Indian tax law, the scope of the transfer pricing provisions was extended to cover specified domestic transactions (popularly understood as domestic transfer pricing). The objective of introducing domestic transfer pricing provisions was to prevent tax leakage from manipulated pricing between local entities of a group. The regulations required payments to related parties and any transactions between units enjoying a tax holiday with other units to comply with transfer pricing provisions. While there may be a possibility of tax arbitrage in the latter type of transactions, the former covered transactions which did not result in any tax arbitrage. With a view to reducing the compliance burden of taxpayers in respect of such transactions, the scope of the domestic transfer pricing provisions is proposed to be curtailed[1].

The amendment proposes excluding payment to related parties from the ambit of transfer pricing. After amendment, the domestic transfer pricing provisions would apply only to transactions where at least one of the parties or any unit of the party to a domestic transaction enjoys a profit linked tax incentive and the cumulative value of such transactions exceed INR 200 million in a tax year. The amendment will be effective from the fiscal year beginning 1 April 2016.

This is a welcome amendment which will go a long way to ease doing business in India.

Secondary adjustment

Hitherto, existing transfer pricing legislation in India provided for a primary transfer pricing adjustment, if the transactions are not entered into at arm's length price. A primary adjustment is effected by increasing the income or decreasing the loss declared by the taxpayer in the tax return of the relevant year.

Current Indian transfer pricing regulations aim to allocate taxable profits between associated enterprises on an arm's length basis, but were not sufficient to tax the 'cash benefit' that also got transferred through intra-group transactions. With an aim of discouraging mispricing intra-group transactions, which result in not only transferring taxable profit from one country to another, but also transferring an economic benefit, the Budget 2017 proposals introduce a secondary adjustment[2] in cases where the primary adjustment exceeds INR 10 million, unless corresponding cash is repatriated to India.

Under the proposed provision, where a primary adjustment results in an increase in the taxable income or decrease in the loss of the taxpayer, the corresponding amount will be deemed to be an advance made by the taxpayer to the AE if the same is not repatriated to the taxpayer in India within a specified period. Interest would then be computed on such advance and will be treated as income of the taxpayer. Such treatment would continue until such time as an amount corresponding to the primary adjustment is remitted back into India.

The secondary adjustment would apply where the primary adjustment to the transfer price has been:

(i) Made by the taxpayer on his own initiative in his return of income;

(ii) Made by revenue authorities and accepted by the taxpayer;

(iii) Is determined in an APA or MAP; or

(iv) Made under the safe harbour rules.

A secondary adjustment would not be required if the primary adjustment does not exceed INR 10 million and is in respect of the fiscal year 2015-16 or earlier years.

An interesting aspect of the proposed secondary adjustment provisions is that it not only requires repatriation of the cash equivalent but also requires an adjustment in the books of account of the Indian taxpayer and its associated enterprise.

The secondary adjustment provisions would be effective from the fiscal year beginning 1 April 2017.

Limiting deduction of interest

In continuation with India's commitment to implement various measures to address BEPS concerns reflected in 15 Action Plans finalised by OECD/G20, the Budget 2017 proposes implementing the spirit of best practice recommended in the Action Plan 4 by limiting the deduction of excessive interest.

The proposed section[3] is applicable to an Indian company or a permanent establishment of a foreign company in India. It seeks to limit the deduction of interest or similar consideration payable in respect of any debt availed, to a non-resident associated enterprise, to 30% of EBITDA, where such consideration exceeds INR 10 million. 'Debt' has been widely defined to include a loan, financial instrument, lease, derivative or any arrangement that gives rise to interest, discount or other finance charges. The limitation will also apply to guarantees and amounts borrowed against corresponding funds deposited with a third party lender by an associated enterprise. Interest in excess of the specified limit can be carried forward (up to eight tax years) and set off against profits and gains of a business or profession in subsequent years. Banking and insurance companies have been excluded from the application of this provision.

The amendment is proposed to be applicable from the fiscal year beginning 1 April 2017.

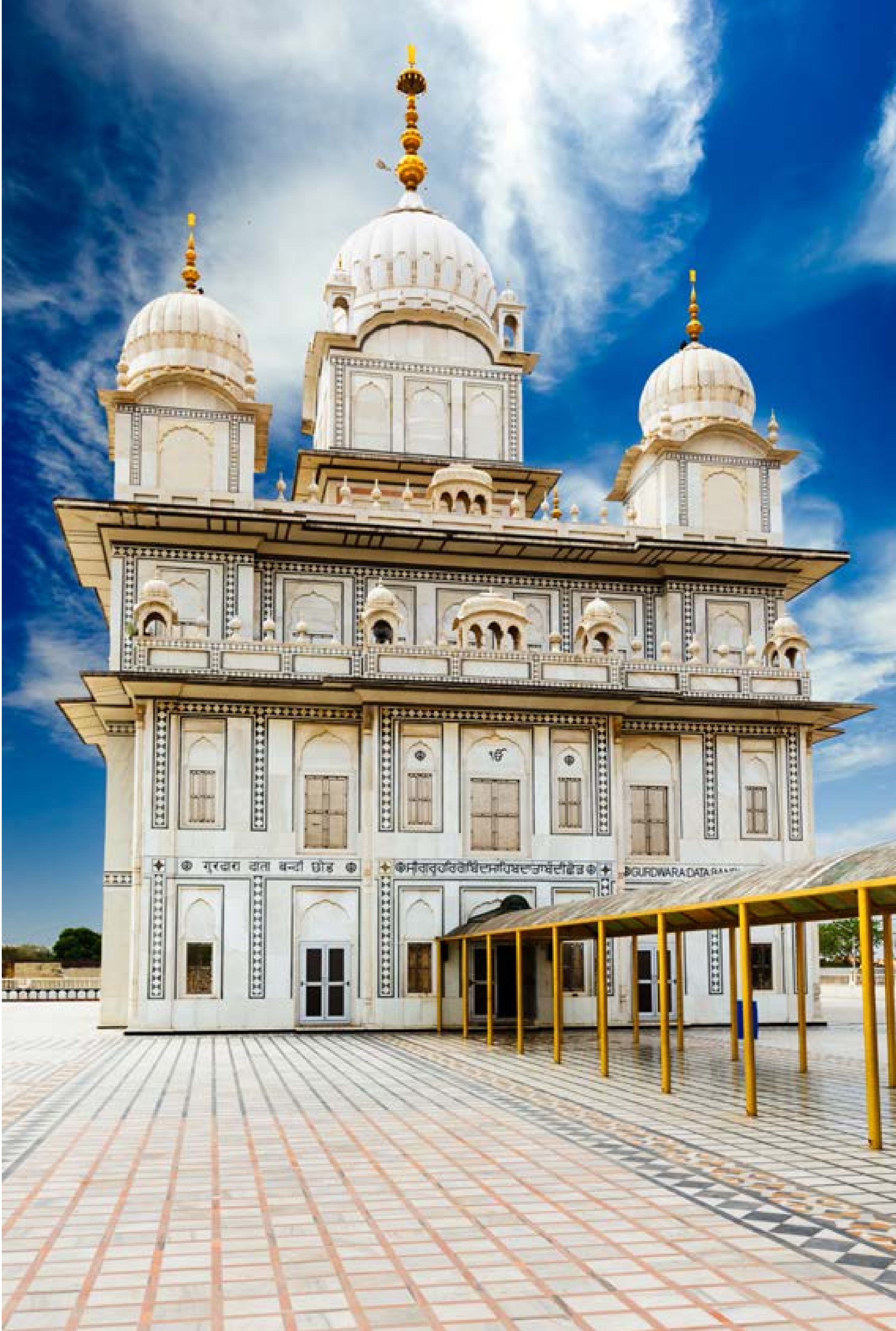
JIGER SAIYA
Mumbai – India
jigersaiya@bdo.in

ABHAY KUMAR
Mumbai – India
abhaykumar@bdo.in

[1] *Proposed deletion of Section 92BA(i) of the Income-tax Act, 1961.*

[2] *Proposed insertion of Section 92CE of the Income-tax Act, 1961.*

[3] *Proposed insertion of Section 94B in the Income-tax Act, 1961.*


GURDWARA DATA

IRELAND

THE EU STATE AID CASE AGAINST APPLE

As readers will be aware, the European Commission (EC) has found that Apple was provided with illegal state aid in Ireland, and the Irish Government must now arrange to collect back taxes of circa EUR 13 billion plus interest. The Irish Government and Apple are appealing the Commission's findings at the General Court of the European Union.

Background

In August 2016 the EC announced its decision in the Apple State aid investigation. The EC had enquired into Irish tax rulings provided to Apple in 1991 and 2007. The rulings relate to the Irish Revenue Commissioners' confirmation of Apple's approach to determining the taxable profits of the Irish branches of Apple Sales International (ASI) and Apple Operations Europe (AOE).

ASI and AOE are Irish incorporated companies that were understood to be managed and controlled outside of Ireland. They are ultimately controlled by Apple Inc. ASI and AOE had entered into cost sharing agreements with Apple Inc. in order to allow the companies to use Apple's intellectual property in order to manufacture and sell Apple products to non-US jurisdictions.

ASI and AOE operate in Ireland through their Irish branches. Under the Irish tax legislation that was applicable during the period reviewed, ASI and AOE were considered to be non-Irish tax resident and were subject to tax in Ireland on the profits allocated to the Irish branch activity only.

The EC has determined that the Irish Revenue Commissioners endorsed an artificial profit allocation. The EC considers the profit allocation to be artificial as it does not reconcile with the actual activities at the head office level.

Information on Ireland's appeal

The Irish Department of Finance ('the Government') recently released an explanation of the main lines of argument in Ireland's annulment application which was lodged with the General Court of the European Union on 9 November 2016.

At the outset of the appeal explanation, the Government asserts that the opinions (or rulings, as per the EC determination) provided to Apple in 1991 and 2007 involve no departure from Irish law, as they simply applied Section 25 of the Taxes Consolidation Act 1997. Section 25 refers to the Irish domestic tax rules applicable to Irish branches of non-Irish resident companies. Section 25 seeks to apply Ireland's territoriality in tax matters such that only profits attributable to an Irish branch are taxed in Ireland and not the non-Irish or worldwide profits on the non-resident company.

The Government is also of the view that the Commission's decision has mischaracterised the activities and responsibilities of Apple's Irish branches. The Government states that the branches carried out routine functions; however, all important decisions were carried out in the USA and the profits deriving from those decisions are not properly attributable to the Irish branches.

The Government says that *"The Commissions attribution of Apple's Intellectual Property licences to the Irish branches [of Apple] is not consistent with Irish law and, moreover, is inconsistent with the principles it seeks to apply, as is its stated refusal to take into account the activities of Apple Inc."*

The Government goes on to outline eight further specific lines of argument:

1. **The Commission has misapplied State Aid law**
   The Government states that the opinions did not depart from normal taxation and that all tax due under Section 25 was paid.

   It is of the view that the Commission's reference system wrongly ignores the distinction between resident and non-resident companies.

   The Government says that the Commission is trying to re-write Irish tax rules so that the Commission's version of the arm's length principle (ALP) should have been applied. The Government notes that this principle is not part of EU law or the relevant Irish law in relation to branch profit attribution.

   The Government states that the Commission's claims encroach on State sovereignty in the area of direct tax.

2. **The Commission has wrongly applied the arm's length principle**
   The Government notes that even if the ALP were legally relevant then the Commission failed to apply it consistently or to examine the overall situation of the Apple group.

3. **The Commission has wrongly concluded that the tax treatment of ASI and AOE was not consistent with the arm's length principle**
   The Commission wrongly rejected expert evidence showing that even if the ALP applied then the tax treatment of ASI and AOE was consistent with that principle.

4. **The Commission's alternative line of reasoning misunderstands Irish law**
   The Commission is wrong to maintain that ALP is inherent in Irish law or that Section 25 was applied inconsistently. Section 25 confers no discretion on the Irish Revenue Commissioners.

5. **The Commission has failed to follow required procedures**
   The Commission never clearly explained its State Aid theory during the investigation and the Decision contains factual findings on which the Government never had an opportunity to comment.

6. **The Commission wrongly invokes novel legal rules**
   The Commission infringed the principles of legal certainty and legitimate expectation by invoking alleged rules of EU law never previously identified.

7. **The Commission has exceeded its powers and interfered with national tax sovereignty**
   The Commission has no competence, under State Aid rules, unilaterally to substitute its own view of the geographic scope and extent of the Member State's tax jurisdiction for those of the Member State itself. The purpose of the State Aid rules is to tackle State interventions which confer selective advantage. The State Aid rules by their nature cannot remedy mismatches between tax systems at a global level.

8. **The Commission has failed to provide proper reasons for its decision**
   The Commission has relied on grossly divergent factual scenarios, it has contradicted itself as to the source of the rule that Ireland is said to have breached, and in suggesting that Ireland granted aid in relation to profits taxable in other jurisdictions.

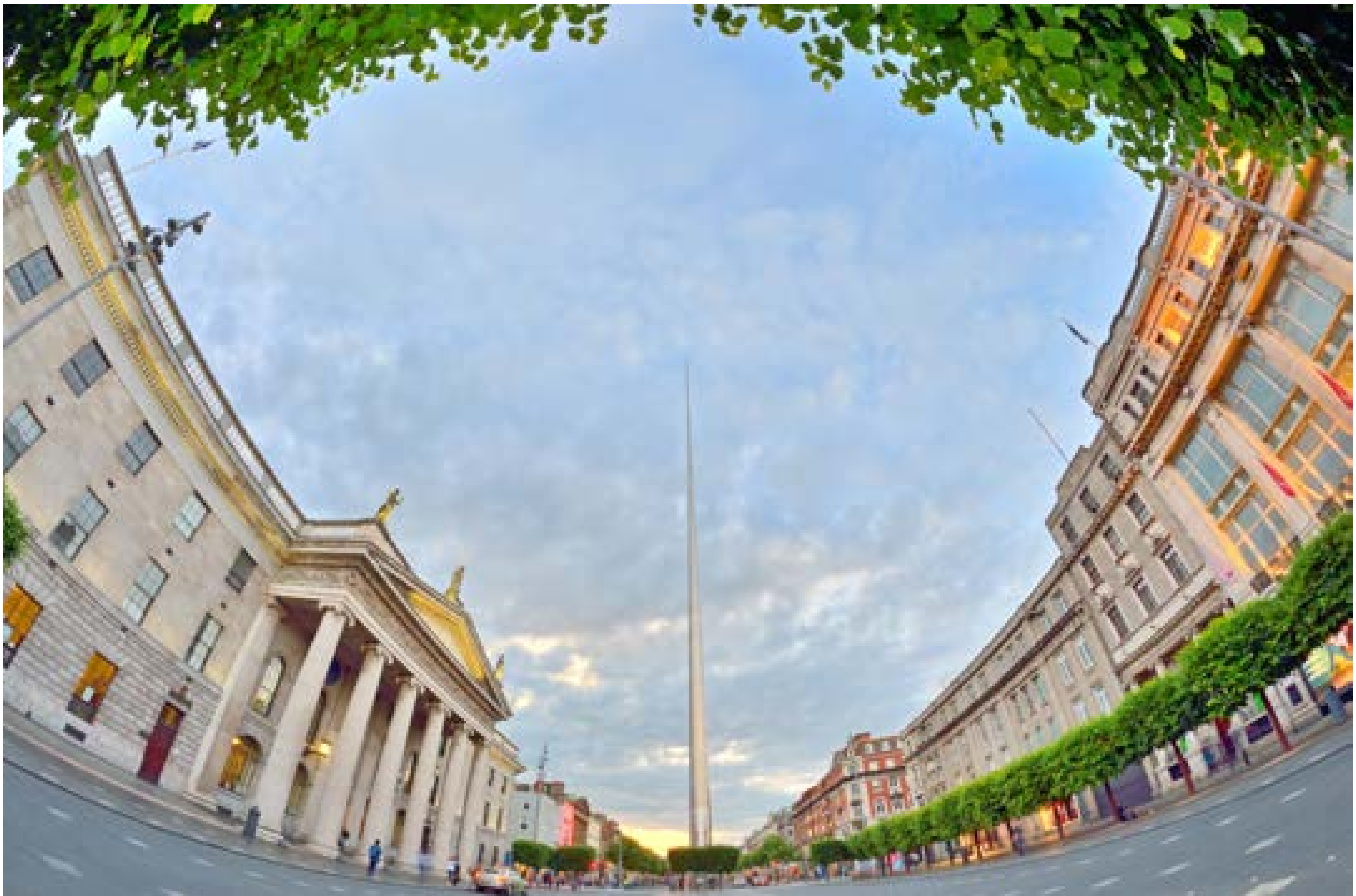
The European Commissioner for Competition attends an Irish government debate on the state aid findings

After the above appeal details were made public, the European Commissioner for Competition, Ms Margrethe Vestager, attended an Irish Government Committee meeting on 31 January 2017. This allowed an opportunity for Irish politicians to probe the Apple decision in more detail. Some comments made by the Commissioner include:

- The Commission's investigation into the Irish and other European rulings began in 2013 after Apple told a US Senate hearing about what it called a tax incentive arrangement with Ireland.
- Ms Vestager rejected the accusation that the Commission is infringing or seeking to infringe on Member State tax sovereignty on a number of occasions.
- At the meeting Ms Vestager appeared to roll back somewhat on the previous comments that back taxes may be due in jurisdictions other than Ireland. She noted that she now believes the majority of the EUR 13 billion is in fact due to Ireland.
- Ms Vestager said the Commission had looked at 19 other companies in coming to their decision and that within those 19 companies, some had more than one ruling.
- Ms Vestager said that when the Commission is looking at transfer pricing rulings, what they are looking for is whether they are backed up by documentation. She said that the reason she reached the Apple decision is that no questions were asked [by the Irish Revenue] and there was nothing to back up the idea that the profits should actually be made in the headquarters.
- Ms Vestager confirmed that at this stage there are no other open investigations regarding Irish rulings.
- Ms Vestager outlined that the Commission did not investigate how Apple organised its operations, how the cost sharing agreement operated, nor did it investigate the value of Apple's Intellectual Property. She said that the Commission investigation was limited to how the tax rulings allocated profits between the branch and the stateless headquarters. With no employees, no premises and no-one to manage the Intellectual Property, all of the profits must be recorded in the Irish branch, according to the Commissioner.
- Ms Vestager said that the Commission is of the view that even in complex situations there must be an economic reality. If someone is generating a profit, someone has to work there, there has to be an office, there have to be functions and they have to be able to take risks, according to Ms Vestager. What the Commission found is that the branch exists in this regard, however the headquarters does not.

Suffice to say that there is a significant difference of opinion in relation to the case between the Irish Government and the EC. The Irish Finance Minister has said that he believes the case will take at least four years to conclude in the European courts. Given the complex nature of state aid law and the uncertainty that the more recent cases have brought to historical activities of certain taxpayers, the fast-tracking of this case in order to get finality on the matter would be welcomed.

KEVIN DOYLE
Dublin – Ireland
kdoyle@bdo.ie



MALAYSIA

INTRODUCTION OF COUNTRY-BY-COUNTRY REPORTING REQUIREMENTS

The OECD commenced its work aimed at addressing tax base erosion and profit shifting (BEPS) by multinational corporations (MNCs) in 2013 at the behest of the G20 and released its final recommendations for the majority of the action points agreed upon on 5 October 2015.

Action Plan 13 of the BEPS project endorsed transparency for tax administration through the use of a new standard of transfer pricing documentation requiring adequate information to be reported to the tax authorities through international agreements such as the Multilateral Convention on Mutual Administrative Assistance in tax matters. The Action Plan also proposed a three tiered structure for transfer pricing documentation: a master file, a local file, and a Country-by-Country Report (CbCR).

Developments in Malaysia

Malaysia is not an OECD member, but observes OECD policies. On 27 January 2016, Malaysia signed the Multilateral Competent Authority Agreement (MCAA) for the automatic exchange of CbCR reporting. An MCAA is an agreement to automatically exchange information based on Article 6 of the Convention on Mutual Administrative Assistance in Tax Matters (CMAA). This signing of the MCAA by Malaysia is a clear indication of its support of the BEPS initiative. Following this, Malaysia also signed the CMAA on 25 August 2016, thereby activating the reporting requirements under the MCAA.

On 23 December 2016, the Inland Revenue Board (IRB) of Malaysia gazetted P.U. [A] 357: Income Tax (Country-by-Country Reporting) Rules 2016, imposing Country-by-Country Reporting requirements on Malaysian taxpayers. The highlights of the CbCR Rules are set out below:

Effective date

– The Rules will be effective from 1 January 2017.

Application

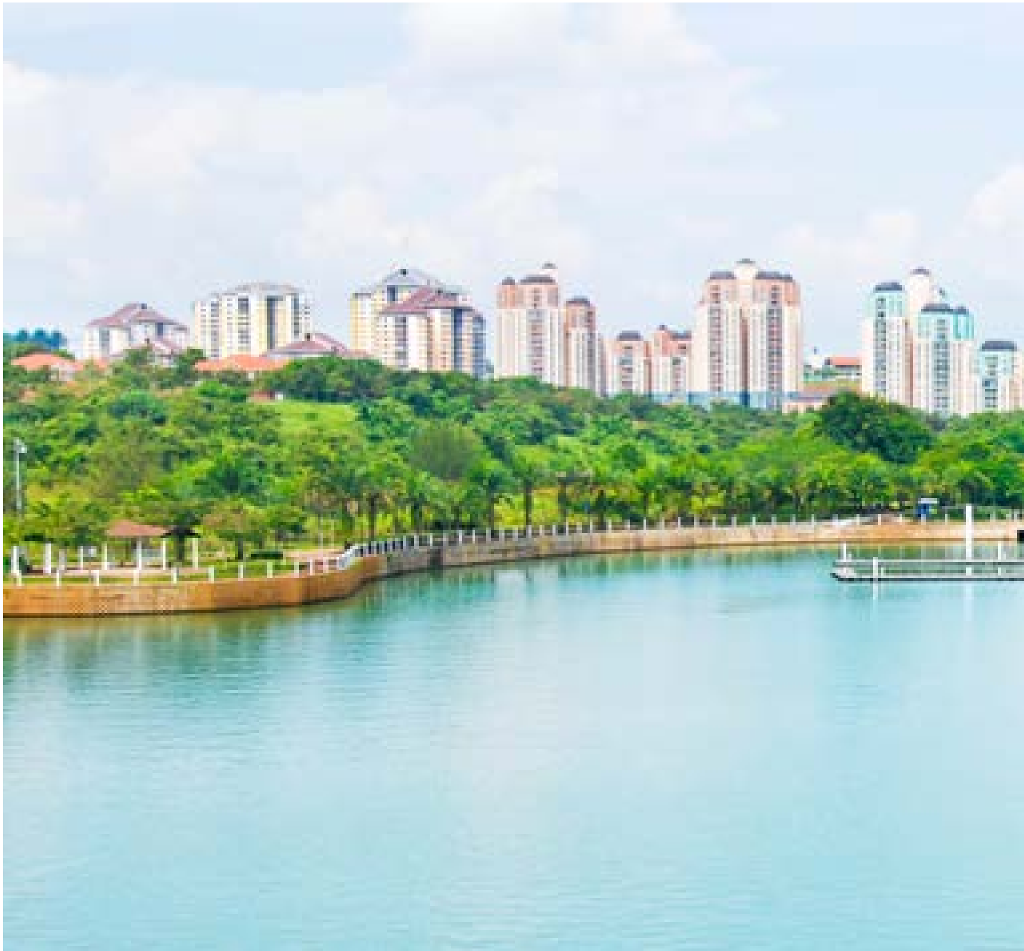
– They will apply to a MNC Group where:
  a. Any of its constituent entities[1] have cross border transaction with other constituent entities;
  b. The total consolidated group revenue in the financial year preceding the reporting year is at least MYR 3 billion;
  c. Its ultimate holding company is incorporated in Malaysia and resident in Malaysia; and
  d. Its constituent entities are incorporated in Malaysia or under the laws of a territory outside Malaysia and resident in Malaysia.

[1] *Constituent Entity means:*

a) *Any separate business unit of an MNC Group that is included in the consolidated financial statements or would be so included if equity interests in such business unit were traded on a public securities exchange;*

b) *Any separate business unit that is excluded solely on grounds of size or materiality from the MNC Group's consolidated financial statements;*

c) *Any permanent establishment (PE) of any separate business unit of the MNC Group mentioned in a) or b) above, provided that the business unit prepares a separate financial statement for such PE.*



Filing of a Country-by-Country Report

- A Country-by-Country Report with respect to a MNC group is to contain:
  a. Data in the form of three tables as endorsed by the OECD in Action Plan 13 of the BEPS project;
  b. The financial information in (a) above is to be denominated in Malaysian Ringgits; and
  c. The CbCR [(a) above] is to be filed in an electronic medium or through an electronic transmission in extensible mark-up language format.

Filing obligation

- The CbCR is to be filed by the Ultimate Holding Company incorporated and resident in Malaysia of the MNC Group.
- The CbCR is to be filed by the Surrogate Holding Company[2] if:
  a. The Ultimate Holding Company is not a resident in Malaysia and not obliged to file CbCR in its jurisdiction of tax residence;
  b. The Jurisdiction of the Ultimate Holding Company does not have a Qualifying Competent Authority Agreement[3] with Malaysia in effect; and
  c. There is a systemic failure[4].

Notification requirements

- Any constituent entity of the MNC Group resident in Malaysia must notify the Director General in writing if it is the ultimate holding company, on or before the last day of the reporting financial year.
- A constituent entity resident in Malaysia who is not the reporting entity[5] must notify the Director General in writing of the identity and tax residence of the reporting entity, on or before the last day of the reporting financial year.

As an example, if the Malaysian Constituent Entity has a financial year closing on 31 December 2017, then the Constituent Entity should notify the Director General prior to 31 December 2017.

Timing of filing

- The CbCR is to be filed not later than 12 months after the last day of the reporting year. For example, if the financial year closing of an applicable MNC Group is 31 December 2017, the CbCR is to be filed by 31 December 2018.

Use and confidentiality of CbCR information

- CbCR information is to be used by the tax authorities in assessing high level transfer pricing risk and other BEPS related risk.
- It will not be used for detailed transfer pricing analysis.
- The confidentiality of the information in the CbCR will be reserved.

Penalty provisions

Penalty provisions introduced by the IRB, namely, under sections 112A, 113A and 119B of the Malaysia Income Tax Act, 1967, are aimed at penalising non-compliance with the new rules. These provide for fines of between MYR 20,000 and MYR 100,000, or six months imprisonment, or both.

Conclusion

Further to the above developments, MNC Groups with their ultimate parent incorporated and resident in Malaysia with consolidated Group revenue in excess of MYR 3 billion will face the onerous task of preparing and filing the CbCR with the IRB. Malaysian based subsidiaries of MNC Groups headquartered overseas will also have to notify the IRB of their ultimate parent who will be filing the CbCR. The developments clearly indicate the IRB's increased scrutiny on transfer pricing issues involving Malaysian taxpayers in line with global developments.

PHILIP YEOH
Kuala Lumpur – Malaysia
philipyeoh@bdo.my

[2] *Surrogate Holding Company means a constituent entity of a MNC Group that is resident in Malaysia and appointed by the MNC Group as a sole substitute for the ultimate holding company to file the CbCR.*

[3] *Qualifying Competent Authority Agreement means an agreement which requires the automatic exchange of CbCR between governments where both are parties to an international agreement.*

[4] *Systemic Failure – a jurisdiction has a MCAA to exchange CbCR with Malaysia, but:*
a) Has suspended automatic exchange of CbCR for reasons other than those in the agreement;
b) Has persistently failed to exchange CbCR in their possession of the MNC having a constituent entity in Malaysia.

[5] *Reporting Entity means the Ultimate Holding Company or a Surrogate Holding Company, if the conditions under the **filing obligation section** for a Surrogate Holding Company are fulfilled.*

PUERTO RICO

PROPOSAL OF NEW TRANSFER PRICING REGULATIONS

At present, Puerto Rico does not have any formal transfer pricing regulations. There is no mandatory disclosure of inter-company transactions in the tax return, nor is there any obligation to keep a transfer pricing documentation file. However, after the First Circuit of the United States Court of Appeals upheld the Puerto Rico Federal District court decision in favour of Wal-Mart Puerto Rico against the Puerto Rico Secretary of Treasury, this situation is about to change.

Wal-Mart Puerto Rico vs. Secretary of Treasury

The Puerto Rico unit of Wal-Mart Stores Inc. sued the Puerto Rico Government, seeking to overturn a tax the retailer calls unfairly high. On 29 May 2015, the Governor of Puerto Rico signed into law Act 72-2015 ('Act 72'), legislation that increased the Tangible Property Component of the corporate Alternative Minimum Tax (AMT) – i.e. the component that taxes the value of property transferred to an entity doing business in Puerto Rico from a related party outside of Puerto Rico – from 2% to 6.5% for entities that have gross revenues of more than USD 2.75 billion from a trade or business in the Commonwealth. Wal-Mart argued that there was an important exemption to this tax, in favour of local business: property transferred from a related party located in Puerto Rico is exempt from the Tangible Property Component of the AMT.

Wal-Mart established that Act 72's dramatic increase in the Tangible Property Component of the AMT – which by definition affects only commerce flowing into Puerto Rico from outside Puerto Rico – has raised Wal-Mart PR's estimated income tax to an astonishing and unsustainable 91.5% of its net income. On information and belief, Wal-Mart PR is the only entity in Puerto Rico that bears this heavy tax burden, as it is the only company that falls into the new AMT's highest tax bracket. The 91.5% effective tax rate is three times the average effective tax rate that Wal-Mart's affiliated companies pay worldwide, and on information and belief it is one of the highest – if not the highest – taxes in the world[1].

As a result of the proceedings, the District Court ruled that the AMT violates:

(1) The dormant Commerce Clause;

(2) The Equal Protection Clause; and

(3) The Federal Relations Act. In particular, the dormant Commerce Clause prohibits states from taxing transactions differently, based on whether the transactions are interstate or intrastate.

The US First Circuit Court of Appeals decision reaffirmed the District Court decision about the unconstitutionality of the arbitrary impositions on related party transactions provisions of Act 72-2015; but also, it emphasises the fact that Puerto Rico needed to work with regulations to guide the companies on their transactions among related parties similar to those in existence in the Federal Tax System and worldwide.

[1] *Wal-Mart Puerto Rico Inc. v. Zaragoza-Gómez, 15-cv-3018, United States District Court, District of Puerto Rico (San Juan).*

Results

In March 2016, as a result of the United States First Circuit Court of Appeals decision, the Government of Puerto Rico started the process to create a set of transfer pricing regulations. On 19 November 2016, the PRTD issued a draft on Proposed Regulation Articles 1040.09-01 to 1040.09-22, to Regulation No. 8049 of 21 July 2011, with the purpose of establishing transfer pricing rules and guidelines. The proposed regulations are aimed at aligning Puerto Rico's Transfer Pricing rules with global norms.

However, since most transactions subject to transfer pricing by Puerto Rico-based entities occur with related companies in the US, the proposed regulations have a mix of Section 482 of the Federal Internal Revenue Code (IRC) and guidelines from the Organisation of Economic Co-operation and Development (OECD) Guidelines.

The PRTD requested comments and suggestions on the proposed draft. BDO Puerto Rico evaluated the proposed draft regulations and commented on discrepancies found throughout the documents. Most of these discrepancies resulted from the intent of trying to use both IRC regulations and OECD guidelines. Some of our comments are as follows:

- Internal Revenue Code vs. OECD Guidelines: since there are some differences between the IRC Code Section 482 and the OECD Guidelines, additional clarification may be added. An example would be that the cost sharing safe harbour rules are different between the two. The proposed regulations should include provisions pertaining to tools and procedures available to taxpayers for dispute resolution.
- The proposed rules should be modified to provide that all taxpayers deal with transactions at arm's length prices. As per Article 1040.09-2(b)(2), these proposed rules only apply to large taxpayers as defined on the Puerto Rico Internal Revenue Code of 2011 or those that are part of a group with more than USD 10 million in gross sales volume or average assets.
- The proposed regulations do not require any specific documentation similar to 6662 of the IRC or Chapter V of the OECD guidelines. If documentation is expected to be required, we recommend adding to this section what the requirements would be and whether there will be penalty protection.
- There are inconsistencies between the Best Method Rule (Article 1040.09-7) and the Preferred Method sections (Article 1040.09-6(h)). These differences need to be evaluated and eliminated to avoid taxpayers' misunderstanding.
- The draft regulations included a wording that established *"a minimum of two comparable uncontrolled transactions must be analysed when applying the interquartile range"*. We understand this additional wording is unnecessary and should be eliminated if the idea is to have regulations that mirror US and International standards.
- The regulations do not propose safe harbour rules for inter-company loans. The establishment of safe harbour rules would provide certainty and ease of application.
- Arm's Length Methods: current examples in Articles 1040.09-11 to 1040.09-16 on the application of certain transfer pricing methods are limited.
  - General description of the methods: there should be a clear distinction between the methods available for tangible property, intangible assets, loans and services. Additional samples to clarify the applicability of each method would also be useful.
  - Comparable Profit Method (CPM) vs. Transactional Net Margin Method (TNMM): The Proposed Regulations should clarify which is the preferred method between the CPM and the TNMM, given that the IRS allows the use of the CPM instead of the TNMM.
- Base Erosion and Profit Shifting (BEPS): we recommend considering the applicability of BEPS reporting requirements.

Summary

At present, the proposed regulations have not been approved by the PRTD. BDO is actively monitoring and verifying the PRTD's steps in applying and implementing the official set of regulations for transfer pricing. One last thing to keep in mind is that the recent change of Government may affect the process and timeline in implementing the regulations depending on the priorities of the new Government in charge.

For further information and/or inquiries, please contact BDO Puerto Rico:

ALINA RIVERA
San Juan – Puerto Rico
arivera@bdo.com.pr

DIALY OTERO
San Juan – Puerto Rico
dotero@bdo.com.pr

SPAIN

RECENT DEVELOPMENTS – THE SII VAT SYSTEM AND POTENTIAL IMPACT ON TRANSFER PRICING MONITORING

Snapshot of the new SII system in Spain

A new controlling strategy in the tax management introduced by the Spanish Tax Agency (AEAT) is evidenced by the new mandatory reporting system which will come into effect on 1 July 2017: the Immediate Supply of Information system (SII). This new reporting standard is compulsory for large companies (i.e. with a turnover of more than EUR 6 million) and corporate groups for VAT purposes, among others.

The new system requires the direct submission of information on invoices issued and received, as follows: a description of the transaction, identification of the entity receiving or issuing the invoice, transaction date, taxable base, etc.

The deadlines for submitting the information are:

i. For issued invoices, four days after the issue date of the invoice;

ii. For invoices received, four days after its accounting entry.

The required information is not new in terms of documentary information, and is aligned with the VAT Community Directive (DIRECTIVE 2006/112/EC). The novelty, however, lies in the detail and availability of the information that needs to be supplied.

First steps towards an environment of coherence, transparency and control – importance for the transfer pricing cycle

The new control system is described within the 2017 Tax Action Plan published by the Spanish Tax Authorities (STA) last January (the 'Plan').

The Plan is driven by tackling tax fraud, but it has also been built on BEPS action plan principles aiming at making MNEs´ business decisions and plans more aligned to the spirit and purpose of the reports.

In this way, and although it is not foreseen for the moment, with the new system and with the new information promptly collected, the STA will in practice be in a position to modify the tax self-assessment method in Spain, and apply a declaration-tax assessment procedure by confirming or rejecting data declared, or to apply other types of action included in the Tax Code (e.g. a limited tax audit).

In the future, the STA will have online access to all – or almost all – information on transactions submitted by taxpayers, whether or not these transactions are subject to VAT, and whether they are between related or non-related parties, etc.

This new availability could eventually affect the implementation and policies of transfer pricing systems in certain industries. At this point, it is worth considering this new system within the multiple steps that are being taken internationally regarding exchange of information, both between tax and customs authorities and between jurisdictions. Henceforth, it seems that transfer pricing risks will increase substantially for MNEs with transfer pricing policies not aligned with their business cycle and value chain.

Practical effects

In practice, it is very likely that a MNE will undertake intra-group transactions, some widely known by the Administration in Spain, such as:

- Purchase and sale of products (Spanish entity as distributor profile);
- Year-end transfer pricing adjustments;
- Inter-company services (any type).

By way of example, in a transaction involving the purchase of goods for subsequent distribution in Spain, any type of costs borne by a Spanish entity would become available to the STA almost immediately. If the Spanish entity is acquiring similar products or any kind of products but performing similar functions, it will be easier for the STA to find internal comparables, and moreover, to determine if costs borne by the taxpayer are not aligned with its pre-defined functional characterisation (pre-transport, marketing, etc.).

With regard to intra-group services, these are well known in Spain, so the STA can challenge the weakness of intra-group services policies where there is no robust benefit test. Having this in mind, after next July, the STA will have information on the services received by Spanish taxpayers both from related and non-related entities and, therefore, will see the specific description of the transaction (e.g. management fee, IT services, etc.). With this information, it will be easier for the STA to identify and find comparable service transactions or possible duplication of services. Notwithstanding that, whilst such a comparison will not necessarily trigger a tax adjustment, because it would need a specific assessment of the services provided, taxpayers need to be aware of such a situation.

In addition, scenarios like the unwritten but usual practice of a commercial agent participating in the sale and purchase of goods, or bearing inter-company services, or a distributor registering a year-end transfer pricing adjustment if its profits do not meet internal policy, will be informed and available to the Tax Authority on an almost daily basis. Despite the fact that some issues do not directly affect the total remuneration of a related entity, they do affect the timing of tax collection from the STA's perspective.

In short, from next July, information that previously was only identified by the Tax Authorities in a tax audit procedure will now be available for them on an almost daily basis. The only current advantage for taxpayers with a potential risk, or with a certain level of risk, is that the STA will find it very difficult to process the enormous quantity and quality of the information they will receive. Nevertheless, it may only be a matter of time before they will be able to launch specific tax audit schemes such as limited tax audits or data checking for tax purposes in order to identify unusual practices. Therefore, Spanish entities that are now obliged to use the new system may view this new requirement not only from the VAT perspective but also as an area of risk for transfer pricing matters.

FLAVIO SÁNCHEZ
Madrid – Spain
flavio.sanchez@bdo.es

CURRENCY COMPARISON TABLE

The table below shows comparative exchange rates against the euro and the US dollar for the currencies mentioned in this issue, as at 18 April 2017.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Australian Dollar (AUD)	0.71381	0.75897
Euro (EUR)	1.00000	1.06318
Indian Rupee (INR)	0.01456	0.01549
Malaysia Ringgit (MYR)	0.21342	0.22693
US Dollar (USD)	0.94044	1.00000

TRANSFER PRICING CONTACT PERSONS

GLOBAL

Zara Ritchie BDO Australia	Tel E-mail	+61 3 9603 1700 zara.ritchie@bdo.com.au
Michiko Hamada BDO USA	Tel E-mail	+1 212 885 8577 mhamada@bdo.com
Dan McGeown BDO Canada	Tel E-mail	+1 416 369 3127 dmcgeown@bdo.ca
Sjoerd Haringman BDO Netherlands	Tel E-mail	+31 10 242 4600 sjoerd.haringman@bdo.nl
Richard Wellmann BDO Germany	Tel E-mail	+49 69 95 941 263 richard.wellmann@bdo.de
Malcolm Joy BDO United Kingdom	Tel E-mail	+44 207 486 5888 malcolm.joy@bdo.co.uk

REGIONAL CONTACTS

Asia Pacific		
Zara Ritchie BDO Australia	Tel E-mail	+61 3 9603 1700 zara.ritchie@bdo.com.au
Eastern Europe		
Ilona Orbok BDO Hungary	Tel E-mail	+36 1 235 3010 ilona.orbok@bdo.hu
Central Europe		
Malcolm Joy BDO United Kingdom	Tel E-mail	+44 207 486 5888 malcolm.joy@bdo.co.uk
South America		
Ariel Efraim BDO Argentina	Tel E-mail	+54 11 4106 7000 aefraim@bdoargentina.com
North America		
Mark Schuette BDO USA	Tel E-mail	+1 404 688 6841 mschuette@bdo.com
Africa		
Roxanna Nyiri BDO South Africa	Tel E-mail	+27 10 060 5000 rnyiri@bdo.co.za

1704-01