

TRANSFER PRICING

Special Issue

In this issue:

Australia

Transfer pricing in Australia

Related party trade was valued in excess of AUD\$270 billion in 2009, representing approximately 50% of Australia's cross border trade flows. Transfer pricing rules are therefore a critical element in the integrity of the Australian tax system. New cross border transfer pricing legislation will be inserted into the Australian Income Tax Assessment Act 1997. The aim of the new legislation is to provide robust transfer pricing rules for multinationals and improve the integrity and efficiency of the Australia tax system.

于2009年，澳大利亚的关联交易之价值超过2700亿美元，占跨境贸易流量约50%。因此，转移定价规则是澳大利亚税务系统完整性的关键因素。澳大利亚的所得税评价法(1997)将加入新的跨境转移定价立法。新立法旨在为跨国公司提供健全的转移定价规则，以及改善澳大利亚税收制度之完整性及效能。

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China

Brief introduction of transfer pricing in China

Transfer pricing is an important part of anti tax avoidance in China. Compared to developed countries, the anti tax avoidance legislation in China has started relatively late, until 2008, under Clause VI of *Enterprise Income Tax Law of the People's Republic of China ("PRC")* and *Regulations for the implementation of the PRC Enterprise Income Tax Law*, it has regulated the terms of special tax adjustment which is the first anti tax legislation including the provisions of Transfer Pricing, Advance Pricing Agreements for cost apportion, Thin Capitalization, Controlled Foreign Corporation, General Anti Avoidance Rules and Interest subject to adjustment of overdue tax on tax avoidance. Within the purpose of supporting the Enterprise Income Tax Law, the *Implementation Measures for Special Tax Adjustments (Trial)* have also been issued by the State Administration of Taxation, following with more than ten related documents. In 2011, the results of works of anti tax avoidance, the tax authorities have made an increased tax revenue by RMB 2.39 billion by the ways of management, service and investigation etc.

转移定价属于中国反避税中的重要组成部分，与发达国家相比，中国反避税立法起步较晚，2008年开始实施的企业所得税法及其实施条例第六章规定了特别纳税调整条款，这是中国第一次较全面的反避税立法，包括了转移定价、预约定价、成本分摊协议、资本弱化、受控外国企业、一般反避税规则和对避税调整补税加收利息等规定。为配合企业所得税法，国税总局又制定了《特别纳税调整实施办法(试行)》，随后陆续下发了十几个相关的规范性文件。2011年，反避税工作通过管理、服务和调查等方式，增加税收达23.9亿元。

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Cyprus

Transfer pricing in Cyprus

The legal framework governing transfer pricing is Section 33 of Income Tax Law which defines in detail which parties and persons are deemed to be related and/or connected based on the principal of direct and indirect control. When associated enterprises or connected persons transact with each other the conditions applied between their commercial and financial relations must not differ from the conditions that would exist, if the enterprises or persons were independent. If there is a difference in those conditions that results in lower tax profits, the tax payer must adjust its tax computation accordingly to eliminate the effect of abusive transfer pricing.

第三十三章收入税法律对转移定价做出规定，基于直接和间接控制的原则，对如何界定应被视为相关和/或关联的当事人做出详细规定。如果企业或当事人是独立的，则适用于关联企业或相关当事人交易时的商业和财务关系的交易，条件必须和适用于独立企业和当事人交易时存在的条件不一样。若这些条件不一样且导致更低税后利润，则纳税人须相应调整纳税计算以消除滥用转移定价的影响。

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Hong Kong

Transfer pricing in Hong Kong

Departmental Interpretation and Practice Notes 48 (DIPN 48) released in March 2012 spells out the procedures that the Inland Revenue Department will adopt in establishing an Advance Pricing Arrangement (APA) in situations where transfer pricing is pertinent. Basically, it follows the Organization of Economic Cooperation and Development (OECD) model and adopts the arm's length principle as the basis of calculating, for tax purposes, the prices of goods and services across borders. APA is most suitable for complex inter-group transactions with high transfer pricing risks (e.g. few comparables can be found, a significant amount of tax is involved or significant profits are shifted out of Hong Kong).

香港税务局于2012年3月发布税务条例释义及执行指引(DIPN)48号文，就此阐明在转移定价的相关情况下实施预约定价安排(APA)之程序。基本上，就税务目的、跨国商品及服务之价格而言，DIPN 48遵循经济合作与发展组织(OECD)之指南与公平独立交易原则为计算基础。对于转让定价风险较高且复杂的集团内个体间之交易（例如较难发现可资比较、牵涉大量税额或大量利润被移出香港），APA会是最适合的安排。

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Indonesia

The changing landscape of transfer pricing in Indonesia

Transfer pricing has entered a more mature stage since 2009 with more rigorous regulations and enforcements in Indonesia. In 2009, the Indonesian Tax Office (ITO) started to demand more by requiring tax payers to submit special appendix which contains related party transactions along with the submission of annual corporate income tax returns (CITR). In 2010, Indonesian transfer pricing had strong grounds with the issuance of PER-43/PJ/2010 (PER-43), the first specific transfer pricing guidance, followed by PER-48/PJ/2010 (PER-48) on the Mutual Agreement Procedure, and PER-69/PJ/2010 (PER-69) on the Advance Pricing Agreement. PER-43 was amended in November 2011 by PER-32 in order to provide clarity with respect to domestic transactions between related parties.

印度尼西亚的转移定价自2009年起已进入比较成熟的阶段，在法规和实施方面比以往严格。印度尼西亚国税局（ITO）于2009年开始要求纳税人提交包含关联交易的特别附录及企业所得税年度纳税申报表（CITR）。于2010年，印度尼西亚发布首份具体的转移定价指引 - PER-43/PJ/2010（PER-43），并接连发布有关相互协议程序的PER-48/PJ/2010（PER-48）及有关预约定价协议的PER-69/PJ/2010（PER-69）。此外，PER-32于2011年11月对PER-43进行修订，以阐明日常关联交易。

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Japan

Transfer pricing trends in Japan

In the recent years, international trades have thrived in an ever-expanding globalized world. In the international taxation field, taxing jurisdiction worldwide is paying close attention to the transfer pricing issue. As a measure to prevent the shift of income (profit) abroad through the transactions between the enterprises and their foreign affiliated entities, transfer pricing taxation have been introduced and/or developed over these years. Japan is a country which introduced transfer pricing taxation rather early, about 25 years ago in 1986.

近年，国际贸易在全球化的世界中蓬勃发展。在国际税收领域中，全球税收管辖区域均关注转让定价的问题。为防止国内外企业和外国附属机构通过双方之间的交易进行收入（利润）的转移，这些年来转移定价税项已被视为一项应对措施，被各国引入和/或开发。日本较早引入转移定价税制，约25年前（即1986年）已有相关税制。

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Malaysia

The latest development of transfer pricing in Malaysia

The Inland Revenue Board of Malaysia (IRBM) has recently issued a new Transfer Pricing (TP) Guidelines and Advance Pricing Arrangement (APA) Guidelines in line with the introduction of the newly gazetted Income Tax (TP) Rules 2012 and Income Tax (APA) Rules 2012, both the Rules and Guidelines are deemed to be effective retrospectively from 1 Jan 2009. While the Rules cover the application of Sections 140A and 138C of the Income Tax Act 1967 ("the Act"), the Guidelines explain the administrative aspects of the Rules.

Section 140A of the Act not only covers cross-border TP transactions but also TP transactions between related companies within Malaysia. The Guidelines has introduced thresholds which exclude certain categories of taxpayers from its requirements. Whereas Section 138C of the Act deals with APA for cross-border related party transactions only.

在公布最新的2012年所得税转移定价规则，以及2012年所得税预先定价安排规则的同时，税收局也推介了该两项规则的指南。而规则与指南的生效日期，提前至2009年1月1日。相关规则概括在1967年所得税法令的第140A及 138C条文之下，而指南则是进一步阐释该规则的行政管理措施。

上述法令的第140A条文，涵盖所有在马来西亚境内进行转移定价交易的相关公司，以及进行跨国界的转移定价交易的公司。指南也规定，除了特定的人士，其他纳税人须一律遵循指南内所定下的门槛。第138C条文则为涉及跨国界预先定价安排交易的公司所制定的。

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Singapore

Transfer pricing in Singapore

Inland Revenue Authority of Singapore ("IRAS") endorses the arm's length principle as the standard to guide transfer pricing. The Singapore Transfer Pricing Guidelines are generally consistent with the Organisation for Economic Co-operation and Development ("OECD") guidelines. Where the pricing of related party transactions is not at arm's length and results in a reduced profit for the Singapore tax payer, IRAS may adjust and tax the profit of the Singapore tax payer under section 34D of the Singapore Income Tax Act.

新加坡税务局（IRAS）认可公平独立交易原则为转移定价的指导标准。新加坡的转移定价指引大致上和经济合作与发展组织(OECD)的指导方针相一致。当关联交易之定价未符合公平独立交易原则而导致新加坡纳税人的利润减少，IRAS可能会根据新加坡所得税法第34D条对新加坡纳税人的利润进行调整及征税。

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Australia



Transfer pricing in Australia

Australia's transfer pricing rules, as set out in Division 13 of the Income Tax Assessment Act 1936, were introduced in 1982 to address emerging concerns about cross-border profit shifting and to coincide with new Organisation for Economy Co-operation and Development ("OECD") guidance on this global tax concern.

Each of Australia's tax treaties contains articles that deal with transfer pricing including the associated enterprise article and the business profits article (the treaty transfer pricing rules). The treaty transfer pricing rules, interpreted through the framework of the OECD guidance, require profits that relate to cross-border intra group dealings to be calculated consistently with the arm's length principle. This internationally accepted principle is set out in the OECD Model Tax Convention on Income and on Capital (OECD Model) and explained in associated guidance material. Australia incorporates its international tax treaties into domestic law through its income tax assessment act.


New cross border transfer pricing legislation will be inserted into the Australian Income Tax Assessment Act 1997. The new legislation contained in Subdivision 815-A will:

1. Ensure that the tax treaty transfer pricing rules are able to be applied independently of existing "domestic" transfer pricing rules and should provide a separate assessment authority. An express reference to the tax treaty pricing rules will be included in the Income Tax Assessment Act 1997; and
2. Require the arm's length principle to be interpreted as consistently as possible with relevant guidance issued by the OECD – by providing direct access to OECD guidance material when interpreting Australia's enacted transfer pricing rules; and
3. Clarify how the transfer pricing rules will interact with Australia's thin capitalisation rules.

New Subdivision 815-A will authorise the Taxation Commissioner to make a determination to negate a transfer pricing benefit for an Australian resident entity where the requirements of an associated enterprises article or the business profits article are met. That is, the new Subdivision will only apply where there is a relevant tax treaty. Broadly, a "transfer pricing benefit" is based on the difference between the profits that an entity would have made having regard to the arm's length principle, and the amount it

actually made. The Taxation Commissioner may make a determination under Subdivision 815-A to adjust the entity's tax position in order to "negate" a transfer pricing benefit. These rules require an allocation of profits consistent with the conditions that might be expected to have operated between independent parties in comparable circumstances dealing on a wholly independent basis.

New Subdivision 815-A will apply retrospectively from 1 July 2004 to ensure that there is alignment between Division 13 and the treaty transfer pricing rules. However, this will mean that entities trading with treaty partners will be subject to stricter transfer pricing rules than those that apply to non-treaty trading partners. Administrative penalties will only apply from 1 July 2012.

The interaction between Australia's thin capitalisation and transfer pricing provisions will also be addressed in the new Subdivision 815-A. The new Subdivision 815-A makes it clear a transfer pricing benefit relating to debt deductions will only arise in relation to an adjustment to the rate of interest and not the level of debt (the thin capitalisation rules operate to determine the maximum level of debt). However, in determining the arm's length rate of interest, it will be necessary to have regard to the level of debt that would be likely to exist if the parties were independent of each other. 

China



Brief introduction of transfer pricing in China

I. Current position of transfer pricing in China

Transfer pricing is an important part of anti tax avoidance in China. Compared to developed countries, the anti tax avoidance legislation in China has started relatively late, until 2008, under Clause VI of *Enterprise Income Tax Law of the People's Republic of China ("PRC")* and *Regulations for the implementation of the PRC Enterprise Income Tax Law*, it has regulated the terms of special tax adjustment which is the first anti tax legislation including the provisions of Transfer Pricing, Advance Pricing Agreements for cost apportion, Thin Capitalization, Controlled Foreign Corporation, General Anti Avoidance Rules and Interest subject to adjustment of overdue tax on tax avoidance. Within the purpose of supporting the Enterprise Income Tax Law, the *Implementation Measures for Special Tax Adjustments (Trial)* have also been issued by the State Administration of Taxation, following with more than ten related documents.

In 2011, the results of works of anti tax avoidance, the tax authorities have made an increased tax revenue by RMB 2.39 billion by the ways of management, service and investigation etc. From the magazine of Transfer Pricing Week published by UK, it stated that in the world's top 10 of the most stringent of transfer pricing systems, China has rose from top 8 in 2007 to top 3 in 2010 which is just behind Japan and India.

Anti tax avoidance has divided into several parts (included type of organization, business transaction, and industry etc) for reviewing and monitoring. For the anti tax avoidance legislation, the anti avoidance tax range has also included the business tax and personal individual income tax. According to the News released by the State Administration of Taxation, the next step for the works of anti tax avoidance is to expand the range of anti tax avoidance legislation and improving the related supporting regulation, perfecting the basic works of anti tax avoidance by taking practical measures, continuing to develop business areas of anti tax avoidance within the needs of economic development, exploring the rules of tax avoidance in each industry and promoting the application of quantitative analysis techniques etc.

II. Recognition of related parties and associated transactions

The Implementation Measures for Special Tax Adjustments (Trial) has clearly indicated the definition of **Associated Relationship and its transactions**:

Associated Relationship - mainly refers to any of the following relationships between an enterprise and another enterprise, organization or individual:

- a) Either party directly or indirectly holds 25% or more in aggregate of the shares of the other party; a third party directly or indirectly holds 25% or more in aggregate of the respective shares of both parties; where either party holds the shares of the other party through an intermediary, as long as such party holds 25% or more of the shares of the intermediary, the percentage by which such party holds the shares of the other party is the one by which the intermediary holds the shares of the other party;
- b) Borrowings by either part from the other party (with the exception of any independent financial institution) account for 50% or more of the actually paid-in capital of such party or 10% or more of the total amount of loans borrowed by such party is secured by the other

party (with the exception of any independent financial institution);

- c) A majority of senior officers (including directors and managers) or no less than one senior director of either party who controls the board of directors is appointed by the other party or a majority of senior officers (including directors and managers) or no less than one senior director of both parties who controls the board of directors is appointed by a third party;
- d) A majority of senior officers (including directors and managers) of either party simultaneously acts as senior officers of the other party (including directors and managers), or no less than one senior director of either party who controls the board of directors simultaneously acts as a senior director of the other party;
- e) The normal production and operation activities of either party is unable to be conducted without the provision of industrial property, proprietary know-how or other franchises by the other party;
- f) The purchase and sales activities of either party are controlled by the other party;
- g) Labor services accepted or provided by either party are controlled by the other party;
- h) Any other relationship in which the production and operation or transactions of either party is materially controlled by the other party or the interests of both parties are associated, including any relationship in which either party, without reaching the shareholding percentage specified in Item (a) hereof, is entitled to basically the same economic interest as the substantial shareholders of the other party, family relationships, kinships and other relationships.

Associated transactions - mainly include the following types:

- a) The purchase, sale, transfer and employment of tangible assets, including the business of purchasing, selling, transferring or leasing buildings, transport vehicles, machinery and equipment, tools, commodities, products and other tangible assets;
- b) The transfer and employment of intangible assets, including the business of transferring titles in franchises such as land-use rights, copyrights (author's rights), trademarks, lists of clients, distribution channels, license numbers, business secrets, and proprietary know-how and in industrial property such as industrial

designs or utility models and of providing the rights to employ such franchises and industrial property;

- c) Financing funds, including all types of short and long-term loans and guarantees, all types of interest-bearing advance payments and delayed payments, and any other business; and
- d) The provision of labor services, including the provision of services such as market surveys, marketing, management, administrative affairs, technology services, maintenance, designs, consultancy, agency, scientific research, legal services, and accounting affairs.

III. Introduction of transfer pricing method

The core work of transfer pricing is the method of transfer pricing, and comparability analysis is the most important basis or standard for selecting the method of transfer pricing. It has divided into two types of transfer pricing methods during the works:

- (a) **Traditional Method** - Comparable price method mainly emphasizes the similarity of the terms of trade. Details are as follows:
 - i) Comparable uncontrolled price method is the pricing method adopted by arm's length parties in conducting same or similar transactions; this method is suitable for all types of transactions, closed to their fair value.
 - ii) Resale price method is a product purchase pricing method that begins with the resale price to arm's length parties (of a product purchased from an affiliated party), reduced by a gross margin of the same or similar transactions; Generally applicable to the businesses with simple processing or pure buying or selling transactions, and it is not applicable to the products sales which has actual add-value to the products (including changed the surface of products, functions, and structures, or replaced the trademarks).
 - iii) Cost-plus method is the pricing method that it is basis on the cost of sales, adding a percentage of the gross margin. One conditions for this method is there is no fail value in the sales market and cost represented fairly. Under the special circumstances, it can used the expenditures (raised during the corresponding period) to convert, such as cost apportion.
- (b) **Non-traditional transfer pricing method** – Refers to a comparable profit method which

mainly emphasizes the comparability of functional risk analysis.

- i) Transactional net profit method is a method by which profits are determined as per the net profit margins of arm's length parties in conducting same or similar transactions. It is usually included return on assets, sales profit, full cost-plus pricing, and Berry ratio etc. This method is the most common method of transfer pricing during practical works.
- ii) Profit split method is a price method by which the consolidated profits or losses of an enterprise and its affiliated parties are allocated between or among them using a reasonable rate. This method has showed both transaction parties have achieved the profits which matched to each party's functions, assets and related risks. It has certain rationality and reflects the principle of independent trading in a certain level.

IV. Introduction of contemporaneous documentation

In accordance with the provisions of *New Regulations for the implementation of Enterprise Income Tax Law*, apart from related parties who have implemented the agreement for cost apportion or Advance Pricing, any enterprise which has reached one of the following conditions shall prepare and keep the record of contemporaneous documentation in the tax years. The main content of contemporaneous documentation shall include organizational structure, operating position, related party transactions, comparability analysis, selection and usage of transfer pricing method. Enterprise shall submit the contemporaneous documentation report of associated transactions within 20 days from the date of the tax authorities required.

The conditions which need to provide the contemporaneous documentation report of associated transactions will be as follows:

- a) The annual purchasing and selling amount between the related parties (processing business shall calculate based on the declaration prices of annual import and export) is no less than RMB 200 million Yuan.
- b) Except for the purchasing and selling business, the annual amount of other associated transactions (if it is financial interest, it shall calculate based on the amount of interest receipts and payments) is no less than RMB 40 million Yuan;

- c) The enterprise has single function and showed a loss of net profit.

V. Transfer pricing risk management

Transfer pricing risk management can be divided into three stages according to the timeliness of the transfer pricing risk:

Before the event: before the associated transactions have occurred, it shall be planned and controlled the related risks, so that it will minimize the transfer pricing risks.

Over the event: managing the transfer pricing risks in a controllable range.

After the event: minimizing the loss of transfer pricing investigation

It shall recommend enterprises to improve awareness of transfer pricing risk management, manage the transfer pricing risk in before, over, and after the three stages. 🇨🇵

Cyprus



Transfer pricing in Cyprus

1. Legal framework

The legal framework governing transfer pricing is Section 33 of Income Tax Law which defines in detail which parties and persons are deemed to be related and/or connected based on the principal of direct and indirect control. When associated enterprises or connected persons transact with each other the conditions applied between their commercial and financial relations must not differ from the conditions that would exist, if the enterprises or persons were independent. If there is a difference in those conditions that results in lower tax profits, the tax payer must adjust its tax computation accordingly to eliminate the effect of abusive transfer pricing.

Non-resident tax payers and foreign tax authorities that wish for a corresponding adjustment in a Cyprus company's/person's taxable profits as a result of a primary adjustment made abroad due to transfer pricing need to apply for a Mutual Agreement Procedure ('MAP') to the Inland Revenue Department ('IRD'). The MAP will follow the European Union's Arbitration Convention route or the Double Taxation Treaty ('DTT') provisions to resolve the case depending on the origin of the claim. If the MAP is successful, the IRD will opt to give a tax credit to the tax payer.

Cyprus tax legislation does not provide for the application of secondary adjustments. A secondary adjustment is an adjustment made in addition to the primary adjustment to deal with excess cash in the hands of an enterprise after a primary adjustment takes place. For example, if a purchase price of a specific invoice is adjusted downwardly to make the transaction as if its terms were at arm's length, then the adjustment value (invoice price vs. arm's length price) is treated as a constructive dividend or a constructive loan or a constructive equity contribution and taxed accordingly.

2. Application of transfer pricing

Cyprus follows the Organization for Economic Co-operation and Development ('OECD') Transfer Pricing Guidelines. Any method described in the Guidelines can be used, provided it is considered the most reliable method for the particular case. Per Transfer Pricing guidelines where traditional transaction methods are equally reliable as transactional profit methods, then they must be preferred.

Traditional transaction methods:

- a. The Comparable Uncontrolled Price ('CUP') method: comparison of selling price/fee of the seller under question with similar transactions between unrelated parties.
- b. The resale price method: comparison of the gross margins of party purchasing goods/services from related parties with similar businesses where the supplier/provider is unrelated.
- c. The cost plus method: comparison of the mark up over costs of a supplier of goods/services to related parties with similar businesses selling to unrelated parties.

Transactional Profit methods:

- a. Profit split method: split of the combined profits of the related parties on the basis of an arm's length agreement.
- b. Transactional net margin method: comparison of net profit indicators.

3. Selection of tax payers for investigation

Tax payers to be reviewed are selected on the basis of risk. Indication of high risk cases as specified above expect to involve transactions with:

- a. tax heavens
- b. related entities that have high tax losses
- c. companies that have tax losses for utilization in a Group Structure (between domestic cases only)

Per Cyprus tax legislation the burden of proof is on the taxpayer, who needs to provide evidential documentation to satisfy the assessor that prices used are at arm's length and that these prices have been decided in accordance with OECD Transfer Pricing Guidelines.

4. Penalties/Interest


Transfer pricing adjustments are considered to fall within the scope of tax avoidance, unless the IRD proves there has been fraud or willful default (tax evasion). Therefore, the provisions of the law relating to tax avoidance will be applied (interest since the tax year in which the avoidance took place and penalties not exceeding 10% of the additional tax imposed).

In cases of fraud or willful default, additional penalties will be imposed, provided that the case is in agreement with the IRD (to avoid further legal action).

5. Disagreement with IRD

Tax payers can object the decision of the IRD in the following bodies:

- (a) Tax Tribunal
- (b) Cyprus District Courts (to appeal the decision of the Tax Tribunal)
- (c) High Court of Justice (to appeal the decision of the District Court)

Please note that Tax Tribunal decisions are binding on the IRD. 

Hong Kong

Transfer pricing in Hong Kong

Where a business operating across different countries or tax jurisdictions, and selling from one subsidiary to another, it is common practice to transfer profits to be taxed to a low tax jurisdiction by means of pricing of the goods. Revenue authorities in the developed countries considered this issue to be the transferring of profits by the pricing of goods and called it "transfer pricing".

The idea is for the high tax jurisdiction to get back its share of the tax by means of adjusting the profits earned by the subsidiary in the low tax jurisdiction. This became an issue first in Organisation for Economic Co-operation and Development ("OECD") countries and later on between Canada and the USA.

Throughout the years, most of the teething problems have been resolved and there is now a rather well

established set of procedures for inter-group transactions profits to be taxed in various jurisdictions.

Take note, however, that each country's revenue authority strives to receive the maximum tax it could extract from the business, rather than its fair share. This, although counter-intuitive, should be fully grasped in dealing with revenue authorities in different countries. Furthermore, each country's revenue authority have a different personality and that personality may not necessarily be the same as the division of the same revenue authority dealing with domestic tax matters.

Transfer pricing has not been a significant issue in Hong Kong in the past because of Hong Kong's low tax rate, which usually means that Hong Kong receives more profits.

It has now become an issue because of the explosion in the number of Double Tax Agreements ("DTA") that Hong Kong has signed and many agreements in the pipeline. To this end, the Inland Revenue Department ("IRD") has issued the following Departmental Interpretation and Practice Notes (DIPN) to deal with transfer pricing in recent years.

DIPN 45 – Relief from double taxation due to transfer pricing or profit reallocation adjustments

DIPN 46 – Transfer pricing guidelines – Methodologies and related issues

DIPN 47 – Exchange of information under comprehensive double taxation agreements

DIPN 48 – Advance pricing arrangement ("APA")

In particular DIPN 48 released in March 2012 spells out the procedures that it will adopt in establishing an APA in situations where transfer pricing is pertinent. Basically, it follows the OECD model and adopts the arm's length principle as the basis of calculating, for tax purposes, the prices of goods and services across borders.

APA is most suitable for complex inter-group transactions with high transfer pricing risks (e.g. few comparables can be found, a significant amount of tax is involved or significant profits are shifted out of Hong Kong).

The IRD has indicated a tentative timeframe of 18 months from the acceptance of the formal application to the conclusion of an APA, with an additional 6 months depending on the availability of the relevant competent authority of the DTA partners. Longer time may be required for more complex cases.

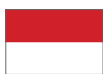
The threshold for an APA application is HK\$80 million per annum for controlled transactions involving sale and purchase of goods; HK\$40 million per annum for

controlled transactions in relation to services; and HK\$20 million per annum for controlled transactions in relation to the use of intangible properties

Companies are encouraged to engage professional advisors, e.g. accountants, throughout the APA process. The appointment of an independent expert may also be required where the procedure stalls or the APA negotiation heads into a deadlock.

Clients with transfer pricing problems or who envisages transfer pricing problems in proposed or contemplated projects, should contact their engagement partners for detailed consultation as soon as possible. 🇮🇩

Indonesia



The changing landscape of transfer pricing in Indonesia

Transfer pricing has entered a more mature stage since 2009 with more rigorous regulations and enforcements. Since then the transfer pricing audit has become more daunting for taxpayers. Transfer pricing itself is not a new issue in Indonesia. It was already introduced in the 1983 Income Tax Law issued by the Indonesian Tax Office (ITO). However, it was never enforced in practice until 2009 with the issuance of Government Regulation (PP) 80 on 28 December 2007, effective on 1 January 2008, which required tax payers engaging in transactions under common control to maintain transfer pricing documentation.

In 2009, the ITO started to demand more by requiring tax payers to submit special appendix which contains related party transactions along with the submission of CITR. In 2010, Indonesian transfer pricing had strong grounds with the issuance of PER-43/PJ/2010 (PER-43), the first specific transfer pricing guidance, followed by PER-48/PJ/2010 (PER-48) on the Mutual Agreement Procedure, and PER-69/PJ/2010 (PER-69) on the Advance Pricing Agreement. PER-43 was amended in November 2011 by PER-32 in order to provide clarity with respect to domestic transactions between related parties.

Previously under PER-43, all domestic related party transactions were subject to transfer pricing documentation requirements. With PER-32, the documentation requirements are only for domestic transactions between related parties that are effectively not taxed on the same basis. Another notable change is the replacement of the hierarchy of transfer pricing methods with the most appropriate method approach in line with the

OECD transfer pricing guidelines. PER-32 adopted, a strict hierarchy in the selection of transfer pricing method of which comparable uncontrolled prices (CUP) method must be considered first, followed by adjusted CUP method, then by one of the two gross margin methods, i.e. resale price method (RPM) or cost plus method (CPM). Net-profit-based methods, such as the transaction net margin method (TNMM), may be applied only if there are “difficulties” in applying one of the more direct pricing methods. Another change is the increased exemption limit from transfer pricing documentation from previously IDR 1 million (approx. US \$110) to IDR1 million (approx. US \$110).

In November 2012, new regulations regarding the conduct of transfer pricing (TP) documentation and audits were being drafted and are expected for release immediately in 2013. The highlights of key potential changes TP guidelines of the upcoming regulations are discussed below.

1. Expanded definition of related party

Current definition includes the following:

- Share participation of 25% or more through direct, indirect or shared)
- Control through management or technology; or
- Family relationships.

The upcoming regulations are likely to include parties involved in Production Sharing Contracts and Contracts of Work. Another major change is the inclusion of major customers and/or vendors which could potentially create disputes in international taxation cases given that this is different from OECD's ruling.

2. Increased threshold for TP Documentation requirements

The proposed exemption limited would be taxpayers with sales or purchase transactions amounting to more than IDR 50 billion (approx. USD 5.5 million) and related party transactions more than IDR 5 billion (approx. USD 550,000) per fiscal year.

3. Amended TP documentation requirements

The new regulation will likely to require TP documentation only for domestic transactions involving taxpayers subject to different tax profiles, such as taxpayers who are subject to different tax rates, taxpayers who are subject to a different tax system (e.g. final tax), transactions that are subject to Luxury Goods Sales Tax, taxpayers reporting significant/abnormal losses, and transactions with oil and gas contractors.

The selection of transfer pricing method is still likely to apply the “most appropriate method” approach. Although the new upcoming regulations would emphasize that the most appropriate method should not disregard the hierarchy of the methods, meaning CUP would always be preferable.

4. Revised Mutual Agreement Procedure (MAP)

The key revision of the MAP regulations is that the MAP application can be processed simultaneously with the domestic dispute resolution process in Indonesia.

5. Revised Advance Pricing Agreement (APA)

Currently, APA – an arrangement where the tax payers and the ITO agree in advance, on an acceptable transfer pricing result for three years- is not commonly pursued in Indonesia as a way out to tax disputes as APA is not a replacement of a tax audit. Therefore, the new regulations are designed to encourage tax payers to negotiate APA.

6. More clarity in intellectual property (IP) transfers

In practice, TP audits have been focusing on related party transactions, in particular royalty payments to related parties. The general rule is that a tax payer must be able to show that the royalty payments meet the three-step test, i.e. verified ownership of the IP, verified benefits from the ownership of the IP, and lastly the payments meet the arm’s length test. The new regulations, therefore, provide more clarifications in determining the arm’s-length nature of IP transfers among related parties. 🇮🇩

Japan



Transfer pricing trends in Japan

1 Background

In the recent years, international trades have thrived as multinational enterprises keep navigating their business operations in an ever-expanding globalized world. In the international taxation field, taxing jurisdiction worldwide are paying closed attention to the transfer pricing issue. As a measure to prevent the shift of income (profit) abroad through the transactions between the enterprises and their foreign affiliated entities, transfer pricing taxation have been introduced and/or developed over these years.

Japan is a country which introduced transfer pricing taxation rather early, about 25 years ago in 1986.

Japan’s transfer pricing taxation applies whenever there is a difference between the price realized from the cross-border transaction between affiliated entities and the price (also called arm’s length price) realized from the transaction between the enterprise and a non-affiliated third party.

Transfer pricing taxation applies to both Japanese entities and foreign entities that have Japanese sourced income.

2 Overview

Japan’s transfer pricing taxation applies to sale, purchase, finance and asset (including intangible asset) transactions performed between a Japanese company and its foreign affiliate entities. Thus it can be said that almost all kinds of international transactions made between affiliated entities are subject to transfer pricing taxation.

There are various transfer pricing methods stipulated in Japan’s transfer pricing rules such as Comparable Uncontrolled Price Method, Resale Price Method, Cost Plus method, Transactional Net Margin Method, and Profit Split Method etc. Among such methods, an entity can choose the most appropriate one to set up arm’s length price.

According to the Act on Special Measures concerning Taxation, tax authority will reevaluate the transfer price when such price evaluated by the enterprise is judged to be not an arm’s length price. If such situation occurs, the enterprise will likely be required to pay additional tax assessed by the tax authority, tax arrears and penalty for late payment. It is advisable that the enterprises shall be very careful with the transfer price setting and comparability process, documentation and justification of pricing policies.

3 Addressing risk inherent with transfer pricing in Japan

1. Documentation

Japanese law does not impose documentation requirements or penalties. Whenever there is a request of transfer pricing examination by the tax authority, the enterprise is required to provide the tax authority with transfer pricing documents. The examination starts with the tax officer’s scrutiny of the enterprise’s transfer pricing documents, then interview on the contents of the documents and finally request of additional documents if necessary. If

the enterprise can't make available the documentation of arm's-length pricing to the tax authority when required, it is very likely that the tax authority may seek a transfer pricing adjustment for the transactions and result in application of the so-called "presumptive taxation" rule which usually ends up unfavorable to the examined enterprise. It is strongly recommended that multinational enterprises maintain proper documentation for the whole group company which can reasonably demonstrate that the results of transactions with foreign affiliated entities have been determined for tax purposes according to transfer pricing rules.

2. Advance Pricing Agreement Program

Japan has an unilateral Advance Pricing Agreement Program which is designed to resolve actual or potential transfer pricing disputes in a principled, cooperative manner, as an alternative to the traditional adversarial process. Under this program, the National Tax Agency agrees not to seek a transfer pricing adjustment for a covered transaction if the enterprise consults with the competent tax authority about the transaction in advance and files its tax return for a covered year consistent with the agreed transfer pricing method. In addition, Japan also has bilateral advance pricing agreements with other countries. Advance Pricing Agreement program is a very useful arrangement that is popularly applied by many enterprises involving transfer pricing worldwide.

Recently, a protocol amending the US-Japan tax treaty was signed whereby an arbitration panel is formed by a third party helping both Japan and US authorities in determining transfer price. 🇲🇵

Malaysia



The latest development of transfer pricing in Malaysia

Transfer pricing (TP) is the intercompany pricing arrangements for the transfer of goods, services and intangibles between associated companies or companies in the same group. A high TP shifts profits to the seller and vice versa. Ideally, TP should be based on arm's length principle, i.e. the prevailing market price which would be reflected in a transaction between independent persons, so as to

avoid the manipulative allocation of profits.

Prior to 1 Jan 2009, there were no specific TP legislations, the Director General of Inland Revenue (DGIR) relied on the general anti avoidance tax provisions and a 2003 issued TP Guidelines to make TP adjustments. Effective 1 Jan 2009, TP is specifically dealt with the enactment of a new Section 140A of the Income Tax Act, 1967 ("the Act"). However, there were no issuances of accompanied new TP Rules nor updated TP Guidelines.

The much anticipated Income Tax (TP) Rules 2012 and TP Guidelines 2012 were issued on 11 May 2012 and 20 July 2012 respectively but are deemed to be effective retrospectively from 1 Jan 2009. The TP Rules cover the application of Section 140A whereas the Guidelines help to explain the administrative aspects of it.

The TP Guidelines exclude transactions of financial institutions, individuals who are not carrying on business, and parties who are both assessable and chargeable to tax in Malaysia where both can prove that any adjustments made will not alter their total tax payables.

On the other hand, the TP Guidelines are applicable on business with gross income exceeding RM25 million and the total amount of related party transactions exceeding RM15 million. As for persons providing financial assistance exceeding RM50 million, they would be required to comply with it too. Nevertheless, the TP Rules have not provided further guidance on thin capitalisation. The above said thresholds would not apply to transactions between permanent establishment ("PE") and its head office or other related branches as PE for this purpose shall be treated as a distinct and separate entity.

There is also an emphasis on the requirement of "contemporaneous" TP documentation, which must be prepared when a person is developing or implementing any controlled transaction; and also where the controlled transaction is being reviewed and there are material changes, the documentation shall be updated prior to the date for furnishing a return for that relevant basis period. The contents of a TP documentation and the documentation requirements of specific transactions such when a tax payer engaged in the provision or acquisition of intra group services, transfer of intangible property or participate in cost sharing arrangement, were clearly stated in the TP Guidelines.

A penalty of 35% of the tax understated will be imposed if there is no contemporaneous TP documentation. Where TP documentation is prepared but not in accordance with the guidelines, a 25% penalty of the tax understated will be imposed.

The following methodologies can be used in determining arm's length price:

- i. Comparable uncontrolled price (CUP) method
- ii. Resale price method
- iii. Cost plus method
- iv. Profit split method
- v. Transactional net margin method

Although tax payers are given the rights to choose any method, the first three "traditional transactional methods" are indicated as the preferred ones. Whereas the last two methods can be used only when traditional transactional methods cannot be reliably applied or cannot be applied at all.

In respect of intra-group services, tax payers need to demonstrate that services have been rendered and the services have conferred an economic benefit or commercial value to the business; and charges for the services are at arm's length. Any charge made by a person in a controlled transaction in respect of the intra-group services shall be disregarded if it involves shareholder or custodial activities, duplicative services, services that provide incidental or passive benefits, or on-call services.

In addition to the above, there is also the Advance Pricing Agreements (APA) Rules and Guidelines which explain the manner in which a taxpayer may apply for an APA from the DGIR/Competent Authority.

Over these years, in line with many competent tax authorities, the Inland Revenue Board of Malaysia (IRBM) has been devoting their time and scrutiny to TP, especially on cross borders transactions involving intra-group services. Hence, the development of these TP Rules and Guidelines, including those on APA, are utmost imperative to enhance taxpayers' compliance. 🇲🇾

Singapore



Transfer pricing in Singapore

Inland Revenue Authority of Singapore ("IRAS") endorses the arm's length principle as the standard to guide transfer pricing. It is an internationally accepted standard adopted for transfer pricing between related parties. The Singapore Transfer Pricing Guidelines are generally consistent with the Organisation for Economic Co-operation and Development ("OECD") guidelines.

Where the pricing of related party transactions is not at arm's length and results in a reduced profit for the Singapore tax payer, IRAS may adjust and tax the

profit of the Singapore tax payer under section 34D of the Singapore Income Tax Act.

A 3-step approach is used to apply the arm's length principle in related party transactions:

Step 1 – Conduct a comparability analysis

Step 2 – Identify the appropriate transfer pricing method and tested party

Other than profit split method, the use of the other transfer pricing methods would require a decision on which party to apply pricing analysis. This party is known as the tested party.

Step 3 – Determine the arm's length results

IRAS is prepared to accept use of ranges, such as an interquartile range to determine an arm's length range provided that the comparables are reliable.

Mutual Agreement Procedures (MAP)

MAP is to provide an amicable way which competent authorities may eliminate double taxation. In a MAP, IRAS would apply its best efforts in eliminating double taxation. A request for MAP is generally accepted by IRAS if, a) it is within the time specific in the DTA b) there is double taxation c) full cooperation is extended by tax payers.

Advance Pricing Agreements (APA)

An APA allows a taxpayer to determine a set criteria to ascertain transfer prices of specific transaction for a specific time frame. IRAS makes APA facility available to tax payers who are engaged in cross border related party transactions. Thereby, allowing certainty and an effective way of resolving transfer pricing issues.

The provisions stated in Singapore tax treaties and Income Tax Act enables requests from tax payers for APAs and to enter such agreements which include unilateral and bilateral APAs.

Transfer pricing for related party loans and services

The IRAS has issued transfer pricing guidelines for related party loans and services in 2009.

Related Party Loans

The comparable uncontrolled price ("CUP") method is the preferred method for determining the arm's length pricing for interest for related party loans. To determine the arm's length interest rate, some factors to consider include:

- a) the nature and purpose of the loan, market conditions at the time the loan was granted,
- b) the principal amount,
- c) Tenure and terms of the loan,

- d) Interest rate prevailing at the sites of the lender and borrower for comparable loans between unrelated parties

It is suggested that suitable reference rates, such as the Singapore Interbank Bank Offered Rate ("SIBOR"), the London Interbank Offered Rate ("LIBOR"), prime rates offered by banks or specific rates quoted by banks.

Related Party Services

IRAS is prepared to accept the charging of the routine support services at cost plus 5% mark up provided that the following routine support services are only provided to related parties such as accounting and auditing services, general administrative services and staffing and recruiting services.

If there is a cost-pooling agreement, IRAS is prepared to accept that services are charged at no mark-up provided that the following criteria are met;

- a) The services are not provided to any unrelated party;
- b) The provision of the services is not principal activity of the service provider, If the cost of providing the services does not exceed 15% of the total expenses of the service provider for that year, the services will not be treated as the principal activity;
- c) Documentation showing that the parties intended to enter into the cost pooling arrangement before the provision of the services.

Documentation

The objective of maintaining documentation is to make sure that taxpayers exercised reasonable efforts to ensure that its transfer prices are consistent with the arm's length. This is to facilitate reviews by IRAS on taxpayers' transfer pricing analyses and assist in resolving any transfer pricing issues that may arise.

- a) By keeping adequate documentation, the taxpayer has further discharged its burden of proof that it has complied with the arm's length principle to put the taxpayer in a better stead to defend its transfer pricing analysis and prevent transfer pricing adjustments arising from reviews conducted by IRAS;
- b) In considering taxpayers' application for Mutual Agreement Procedures (MAP), IRAS would assess the quality of taxpayers' documentation. Taxpayers who have not prepared adequate documentation may realize their application for MAP rejected or transfer pricing issue would be difficult to resolve.

There is no deadline for the preparation of documentation. The documentation should be

readily available should IRAS requests for further clarifications.

Penalties

Understatement of income penalties range of up to four times of tax underpaid and fines applies. Mitigating factors for penalties includes good transfer pricing basis and documentation.

IRAS believes in consultation and cooperation with taxpayers as a mutually beneficial way to assist taxpayers with its compliance. 

International Tax Panel



Malaysia

LL KOONG

Tel: +603 2166 2303

ITP Chairman



China

YAO NING

Tel: +86 10 8589 4393

ITP Vice-Chairman



Hong Kong

CHAN LOK SANG, L.S.

Tel: +852 2541 4188

ITP Vice-Chairman



Japan

NISHIMURA YOICHI

Tel: +81 3 3519 3970



Singapore

IRENE CHAN

Tel: +65 6323 1613



Macau

JACKSON CHAN

Tel: +853 2856 2288



Australia

ADRIAN CALLEIA

Tel: +61 2 9907 1600



Cyprus

ADONIS THEOCHARIDES

Tel: +357 22 670680



Cambodia

NEOH BOON TOE

Tel: +855 17 363 303



Indonesia

HERU PRASETYO

Tel: +6221 2305569



Mauritius

JAMES HO FONG

Tel: +230 210 8588

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