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Transfer Pricing Brief

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Introduction

Welcome to the first edition of *Transfer Pricing Brief*, which we have produced in order to highlight the importance of transfer pricing in your international tax planning. As a result of the BEPS (base erosion and profit shifting) reports issued by the Organisation for Economic Cooperation and Development (OECD) at the end of 2015, European countries have started to adapt their domestic legislation to bring it into line with the new OECD guidelines. Our aim in this publication is to give you an overview of important changes in this area in various European countries.

If you would like more information on any of the countries featured, or would like to discuss the implications for you or your business, please contact the person named under the relevant country or item. The material discussed in this newsletter is meant to provide general information only, and should not be acted upon without first obtaining professional advice tailored to your particular needs.

What is this all about?

Multinational groups of companies (MNEs) use transfer pricing between group entities in different jurisdictions to divide their global profit and to minimise their worldwide tax. They try to erode their tax base in high-tax countries by shifting profits to low- or zero-tax countries. There is only one important restriction with which they must comply – MNEs must take into account the arm's length principle, which means that the conditions for transactions between related entities have to be the same as for the identical or similar transaction between mutually independent entities. MNEs have to provide evidence and document their compliance with this principle in the great majority of jurisdictions around the world in order to avoid the imposition by their local tax authorities of unilateral adjustments leading to tax increases (giving rise to double taxation).

However, due both to the revised OECD transfer-pricing guidelines (by which most nations abide) and to the European Anti-Tax Avoidance Directive (ATAD), tax planning, and certainly transfer-pricing planning will never be the same again. We can seriously talk about a pre-BEPS and post-BEPS period in the tax world.

The action plan against base erosion and profit shifting ('the BEPS Action Plan'), which was completed at the end of 2016, has resulted in 15 reports. However, these can broadly be summarised in three basic principles: coherence, substance and transparency. Coherence aims to align more closely the various laws of individual countries in order to close loopholes and gaps. The importance of substance can be stated as the fact that profits (and corresponding profit taxes) have to be attributed to the location and jurisdiction where the added value is effectively created. Finally, more transparency at the international level will enable national governments to make a better analysis of MNEs' facts and figures, allowing them to make companies pay their 'fair share' of tax in each country.

The transparency aspect contains a complete chapter (Action Plan 13), dedicated to transfer-pricing documentation. It makes recommendations to tax authorities and multinational enterprises on how to document the way that they have arrived at the arm's length prices of their intercompany transactions, using a master file and a local file. For groups of companies exceeding the turnover threshold of EUR 750 million, there has been the introduction of mandatory country-by-country (CbC) reporting. The CbC report has to contain information such as aggregated profit, taxes paid and accrued, cash flow, group investments and the number of employees in each country where the group does business. Moreover, the most important functions of each legal entity or permanent establishment must be explained. Additional information concerning the group's activity and the interaction between group members is also required. This three-tier set of documentation has to be provided to the local tax authorities of the ultimate parent company. These local tax authorities are then supposed to share this information with the other countries where the group has legal entities. Over 100 tax authorities have already signed an agreement committing them to exchange this type of information.

Disclosure of this information will also mean that national governments will gather a great deal of additional information, giving them a very good insight into where profits are made and taxes are paid. Each concerned government will inevitably try to have its own piece of the cake, and taxpayers will have to defend their transfer-pricing strategy on various fronts. Taxpayers will have to ensure that these three sets of documents (local file, master file and CbC report) tell a consistent story – thorough preparation on a global scale preparation will be crucial to avoid problems with local tax audits and reduce the compliance cost.

Action Plans 8, 9 and 10, for their part, are completely dedicated to the technique of transfer pricing. The transfer-pricing guidelines have been refined, partially rewritten, and supplemented with many examples. As a Belgian tax inspector has recently commented, tax authorities have been given a strong weapon against profit shifting and base erosion in their countries.

The focus and emphasis in the new transfer-pricing guidelines can be briefly summarised as follows. The global idea is that companies must be taxed at the location where the value is created. OECD advice is to examine each intercompany transaction in isolation so as to analyse its relevant economic characteristics and determine the correct arm's length price. The conduct of the parties must comply with intercompany agreements and if not, substance is more important than form. In exceptional cases, when no commercial rationale for the transaction can be adduced, transactions may even be disregarded (for transfer-pricing purposes, that is).

Another point concerns risk identification. Entities bearing greater risks expect greater profit and in fact are entitled to all residual profit in excess of routine profits. A complete chapter is dedicated to an approach for risk analysis, referring to the importance of people functions, the financial capacity for assuming the risks and the detection of who is responsible for the consequences of functions and capacity.

Consideration is given to specific subjects such as 'location savings', 'group synergies' and 'commodity transactions'. Even with recent clarifications in the guidelines, however, all these items continue to be difficult to apply, often come into dispute and will continue to add to uncertainty.

However, the part of the action plan describing how to deal with intangibles is much clearer and is punctuated with plenty of examples. Intangibles are a frequent means of profit shifting to low-tax jurisdictions and the new guidelines are aimed at tightening or even rewriting the rules of the game drastically. Under the guidelines, mere legal ownership should give the legal entity concerned no rights to any profits from the intellectual property, but the entity that performs the DEMPE functions (development, enhancement, maintenance, protection and exploitation), the entity that controls the important economic risks (and has the financial power to assume this risk) and the entity that effectively embeds the assets, should be entitled to a return in proportion to their contribution to the value of the property. Hard-to-value intangibles (are there any other?) whose valuation is based on financial projections that are uncertain at the time they are made, may under certain conditions and circumstances be challenged ex post by tax auditors. It is at this juncture also that one may expect further disputes between taxpayers and the tax authorities.

Finally, the OECD's point of view on low-value-added intragroup services, proposing cost plus 5% as a safe harbour, seems at first sight a relief from the hundreds of pages of technical descriptions. However, taxpayers had better be on their guard since it is quite likely that many countries will have their own differing opinions on the deductibility of management fees and HQ expenses.

Initially the BEPS Action Plan was intended to attack the big players such as the Apples, Googles, and Starbuckses of this world. It served to analyse and disclose the international structures MNEs used to minimise tax (considered as a cost) using ingenious and creative techniques, only accessible for groups of a critical size. However, pressure from public opinion, NGOs and tax authorities has led to a great increase in its scope so that all MNEs are now facing a new corporate social responsibility, in particular of paying their 'fair share of tax', however that may be determined.

As a worldwide network of consultants, mainly advising small and medium-sized companies, we are well placed to guide you how to behave in this post-BEPS world. We are convinced that mid-tier groups operating internationally may also benefit from optimising their structures and transfer-pricing policies within the framework of this new reality. As the documentation for an international group has to be in proportion to its size, Moore Stephens Europe offers its clients a 'hands on' and customised transfer-pricing solution.

We hope you will find the contents of this *Transfer Pricing Brief* useful.

Koen Van Dorpe
Moore Stephens Europe Transfer Pricing Steering Group

Austria

Austria introduces standardised transfer-pricing documentation

Until 2016 there was no specific obligation in Austrian legislation to provide TP documentation. On 1 August 2016, the Austrian National Council published the legislation on transfer-pricing documentation, under which the requirement to prepare a country-by-country (CbC) report applies to taxable years beginning after 31 December 2015.

The legislation follows the three-tier documentation approach contained in the OECD's *Transfer Pricing Documentation and Country-by-Country Reporting Final Report* (BEPS Action 13) issued in October 2015, and includes the requirement to prepare a master file, a local file(s), and CbC reports. The documentation must generally be filed in an official language accepted by the tax authorities, i.e. German or English.

Country-by-Country report

The ultimate parent company of a multinational enterprise (MNE) group has to file a CbC report if it is resident in Austria and the global consolidated group turnover exceeded EUR 750 million in the previous year. The deadline for electronic submission of CbC reports is 12 months after the last day of the relevant taxable year.

Master file and local file

All entities belonging to an MNE group that are tax-resident in Austria have to prepare a master file and a local file if the revenues generated in the preceding fiscal year exceeded EUR 50 million. Irrespective of any thresholds, the tax authorities may request the master file of an Austrian-resident entity belonging to an MNE group if the ultimate parent company is required to prepare a master file according to its local legislation.

Smaller companies have to provide documents to the tax authorities upon request premised on general documentation requirements to justify their intercompany pricing.

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Belgium

Belgium introduces mandatory and annual transfer-pricing documentation for multinational enterprises

Until June 2016, there was no obligation in Belgian legislation on companies to provide transfer-pricing documentation, but the situation has changed as from 2 June 2016.

Under new legislation, all Belgian companies that are members of an MNE (multinational enterprise) group exceeding one of the following thresholds in their individual and annual financial statements have to provide each year a master file and a local file.

- EUR 50 million of operational and financial income, excluding exceptional income
- A balance-sheet total of EUR 1000 million
- A staff of 100 FTEs (full-time equivalent employees)

An additional condition (that applies only to the local file) is that the company undertakes intercompany transactions of an average annual value of more than EUR 1 million.

The format of these files will be determined by a Royal Decree. A comparability study and choice of one of the five OECD-recommended transfer-pricing methods will be mandatory.

Second, country-by-country (CbC) reporting is now mandatory for all Belgian ultimate parent companies of an MNE Group with a consolidated annual turnover exceeding EUR 750 million.

Belgian group members that are not the ultimate parent company will nevertheless be required to file an annual CBC report where:

- The ultimate parent company is located in a jurisdiction that does not require CbC reporting in its legislation
- The country of the ultimate parent company does not provide an automatic exchange of the CBC report with Belgium or
- The Belgian tax authorities do not receive the CBC report due to reasons other than those listed above and there is systemic failure

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Czech Republic

Planning implementation of BEPS in Czech tax legislation

Implementation of BEPS recommendations into Czech legislation is following a timetable announced in a Ministry of Finance bulletin issued in April 2016.

Some of the measures to which the bulletin refers are discussed below.

Action 2: neutralising the effects of hybrid mismatch arrangements

This is intended to prevent occasions of double non-taxation or double deductions for the same expenditure item in respect of cross-border transactions, which derive from the different tax treatment of entities or the different way in which the same transaction is treated in one jurisdiction and the other. A typical example would be a payment that is treated as deductible interest in the payer's jurisdiction but as an exempt dividend in the payee's jurisdiction.

Since 1 May 2016, there is a rule in the Czech Republic whereby the company receiving a dividend cannot claim a participation exemption for it where the distributing company may claim a deduction for the same payment in its home state. It is now intended to apply the same rule to prevent exemption of a capital gain on the sale of qualifying shareholdings in the same circumstances.

Action 3: designing effective controlled foreign company (CFC) rules

CFC rules provide that in certain circumstances the profits of a company established in a low-tax jurisdiction may be attributed to its controlling shareholders in a high-tax jurisdiction.

The Czech Republic has no CFC legislation, but there is no exemption from corporate tax for dividends or capital gains from the disposal by a Czech company of shares in a company outside the European Union if the subsidiary is resident in a jurisdiction that does not have a double tax treaty with the Czech Republic or is subject to corporate income tax at a rate lower than 12%

Action 4: Limiting base erosion involving interest deductions

In common with many European states, the Czech Republic restricts the deduction of interest only in respect of interest paid to a related party and where there is judged to be an excessive level of debt. This is determined by reference to the debt-equity ratio of the borrower. In the Czech Republic, related-party debt is considered to be excessive where it exceeds 4:1.

The rule proposed by the OECD would apply more broadly and encompass interest paid also to unrelated parties. It would limit tax deductibility to a pre-determined percentage (10-30%) of EBITDA (earnings before interest, tax depreciation and amortisation). The new rule would be applied to a greater number of companies. The allowability of interest would thus be influenced not only by the relative size of the debt but also by variations in the interest rate.

In times of economic growth, which the Czech Republic is now experiencing, the Czech government will have regard to what effect such a rule would have on the willingness of companies to invest in new projects.

Action 5: Countering harmful tax practices more effectively

The provision regarding the automatic exchange of tax rulings and transfer pricing assessments was enacted in a new law on cooperation on limiting the harmful effect of unilateral assessment of transfer pricing.

Action 8-10: Adaptation of transfer pricing to economic activities

The Czech Republic abides by the market-value rule as the main principle, as reflected in the Income Tax Act and interprets the basic standards through methodological guidelines.

Since 1 January 2015, (beginning with the taxable year 2014), Czech companies have been required to complete an annex to the tax return listing transactions with related parties. The Czech tax authorities use the data from this annex to select taxpayers for audit on a risk-assessment basis. One of the risk criteria is the amount of royalties paid to recipients outside the European Union.

The Czech Republic currently has no provision in its tax rules to stop the movement of assets (intellectual property or patents) into a low-tax jurisdiction. If exit taxation were to be imposed on a change of function, when parts of the supply chain are moved into lower-tax jurisdictions, this might penalise transfers that were not motivated by tax considerations, but e.g. to save on product costs through cheaper labour. The issue of moving valuable assets and hence tax revenues abroad in the face of higher wages and labour shortages may become significant in the Czech Republic.

Action 13: country-by-country reporting

Czech legislation implementing this aspect of the Anti-Tax Avoidance Directive is scheduled to take effect from 5 June 2017.

The obligation to file a country-by-country report will first apply to multinational groups with a consolidated turnover exceeding EUR 750 million in respect of financial years beginning after 31 December 2015. Reports will be due no later than 12 months from the end of the financial year.

The requirement to file will apply to:

- The ultimate parent company
- The representative member of the group or
- The Czech member of the group solely where there is no automatic exchange of information with the jurisdiction of the ultimate parent

The report must be prepared in a standardised form, which will have three parts and will contain:

- Information in summary form relating to the group's activities in each country:
  - Revenues
  - Earnings before tax
  - Tax paid
  - Accrued tax
  - Registered share capital
  - Retained earnings
  - Number of employees
  - Asset value
  - Information about group members and their activities
  - Specification of the data source

Failure to comply with these obligations may result in the imposition of a penalty of CZK 3 million.

Reports filed by Czech entities will be the subject of automatic exchange of information with other tax authorities.

Action 14: making dispute-resolution mechanisms more effective

About 20 cases were resolved under procedures provided in double tax treaties or under the Arbitration Convention in 2015. No case was lodged with the Advisory Commission.

Up to 24 August 2016, the Czech Republic had concluded 86 double tax treaties currently in force and is discussing with its treaty partners how they might be amended to comply with BEPS requirements. However, none of these existing treaties includes an arbitration provision as in Article 25(5), which would guarantee the exclusion of double-taxation in the event of a unilateral transfer-pricing adjustment. The Czech Republic will observe other parties' experience with Art. 25(5) arbitration, before deciding whether to introduce it into its own treaties.

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France

France introduces mandatory and annual transfer-pricing documentation for multinational companies and country-by-country reporting

French companies or French permanent establishments of foreign companies which meet any of the criteria listed below have already, since 1 January 2010, been subject to specific transfer-pricing documentation requirements (under art. L13 AA of the French Tax Procedures Code – *Livre des procédures fiscales*):

- They have total net sales (before taxes), or total gross assets, of EUR 400 million or more
- They have a direct or indirect holding, at the balance-sheet date, of more than 50% of the capital or voting rights in a legal person having such turnover or gross assets
- Such a legal person directly or indirectly holds, at the balance-sheet date, more than 50% of the capital or voting rights in them
- They belong to a French tax consolidated group that includes at least one legal person that meets one of the above criteria

These entities have to provide their transfer-pricing documentation justifying the prices of their intercompany transactions upon request of the tax authorities in the course of a tax audit.

As from 6 December 2013, France reinforced its legislation against tax fraud by introducing a filing requirement that has been codified under art. 223 B *quinquies* of the French Tax Code. Taxpayers who are subject to this requirement must file a transfer-pricing form, no later than six months after the deadline for filing their corporate tax return for the preceding financial year.

As from 1 January 2016, an obligation to file a country-by-country (CbC) report has come into force.

This measure is in addition to the other transfer-pricing documentation requirements and applies to French-resident companies that meet all of the following criteria:

- They prepare consolidated accounts
- They own foreign branches or control, directly or indirectly, one or more foreign-based subsidiaries
- They generate annual consolidated tax-exclusive turnover of EUR 750 million or more
- They are not themselves in the ownership of one or more legal entities established in France and already subject to the French CbC reporting requirement, or by legal entities established abroad that are subject to similar requirements according to foreign legislation

The annual CbC report has to include the following information:

- Revenues from intragroup transactions
- Revenues from transactions with independent parties
- Total revenues
- Pre-tax profits;
- Income taxes paid
- Income taxes accrued
- Registered share capital
- Accumulated earnings
- Number of employees and
- Tangible assets other than cash and cash equivalents

The CbC report must be submitted online to the French tax authorities within 12 months of the end of the group's financial year.

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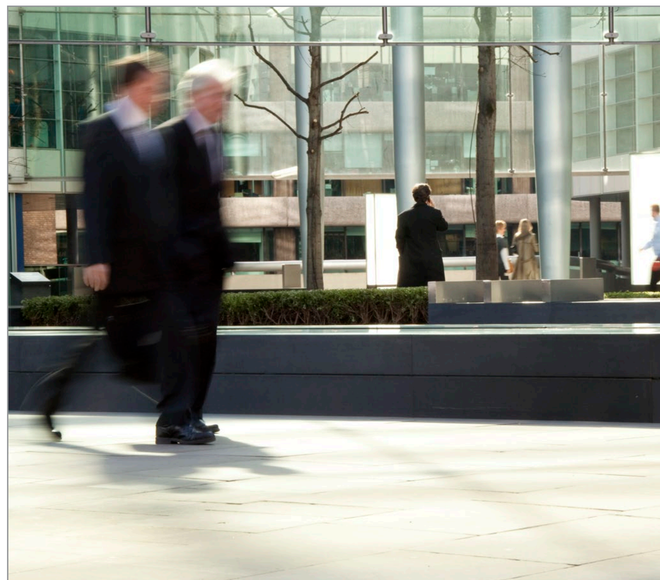

Germany

Implementation of BEPS into German transfer-pricing legislation

On 1 June 2016 the Federal Ministry of Finance (*Bundesministerium der Finanzen*) published its draft for legislating the implementation of the amendments to the EU Mutual Assistance Directive (MAD) and further measures against profit shifting and base erosion.

This draft mainly includes BEPS recommendations and measures deriving from the amended MAD. The priority of the draft is the introduction of country-by-country (CbC) reporting.

Contents of the draft

Action Plan 13 Revision of transfer-price documentation and introduction of country-by-country-reporting

This measure will shortly become law by virtue of the *BEPS-Umsetzungsgesetz I* (the BEPS Implementation Act No I), under which documentation requirements will be codified in s 138a of the *Abgabenordnung* (Tax Code).

Following OECD guidelines, CbC reporting will only be required from groups whose consolidated turnover in the previous taxable year exceeded EUR 750 million.

Qualifying MNE groups will primarily be required to file a CbC report with the tax authorities of the jurisdiction in which the ultimate parent of the group is resident ('the jurisdiction of main affiliation') only. The tax authorities will then share this data with the other states in which the group operates in line with automatic information exchange. Filing in any other jurisdiction (a 'secondary filing obligation') than that of the ultimate parent company may be required where:

- There is no CbC reporting obligation in the jurisdiction of main affiliation or
- No report has been filed in the jurisdiction of main affiliation or
- The jurisdiction of main affiliation has not exchanged the information with the other states involved

CbC reporting is not to be used for immediate adjustment of transfer prices, but there is a risk (not only for the German tax authorities) that transfer prices will be adjusted on other grounds by any of the other states in which the group operates, where they consider the transfer prices not to be adequate. At this point it will be of great importance to agree on a compulsory arbitration method with as many states as possible.

Action Plan 14 More effective settlement of dispute procedures

The joint administration regarding mutual agreement and arbitration procedures will be improved. The number of bilateral mutual agreement procedures is increasing continuously; further increase is to be expected due to implementation of CbC reporting (Action Plan 13). So far, 20 states (the 'Coalition of the Willing') have agreed on an effective and prompt solution of disputes through compulsory arbitration agreements. In Germany, enactment of the *BEPS-Umsetzungsgesetz* I could hasten this process. However, it is essential that the federal tax authorities ensure they have sufficient personnel and equipment for this task.

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Hungary

Hungary eases and clarifies local rules on TP documentation

Hungary introduced mandatory TP documentation for intercompany transactions as long ago as 2005. Since then there has been a lot of practical clarification and facilitation in local TP legislation. Nevertheless, transfer pricing is still an important concern for the Hungarian tax authorities and taxpayers may expect heavy sanctions if they have not prepared TP documentation (a EUR 6500 penalty for failure to prepare TP documentation) or what documentation there is is inadequate.

Exceptions from the obligation to prepare TP documentation have been extended and include:

- All SMEs
- Intragroup intermediary goods and services where the services or goods have been purchased from an independent third party and invoiced to the related party at the same price
- Intragroup transactions where the total annual market value is less than EUR 162 000 (HUF 50 million)

TP documentation may be prepared in a foreign language (English, German or French), but the tax authorities may ask for it to be translated into Hungarian at the taxpayer's cost.

Taxpayers may choose to prepare an EU masterfile and country-specific file. Their choice must be reported to the tax authorities in the corporate tax return.

There are special regulations on low added-value intercompany services, where a profit margin between 3%-10% is acceptable without the obligation to provide a benchmark analysis.

Advance pricing agreements (APAs) are available in Hungary, although the procedure is costly and therefore not very widely used.

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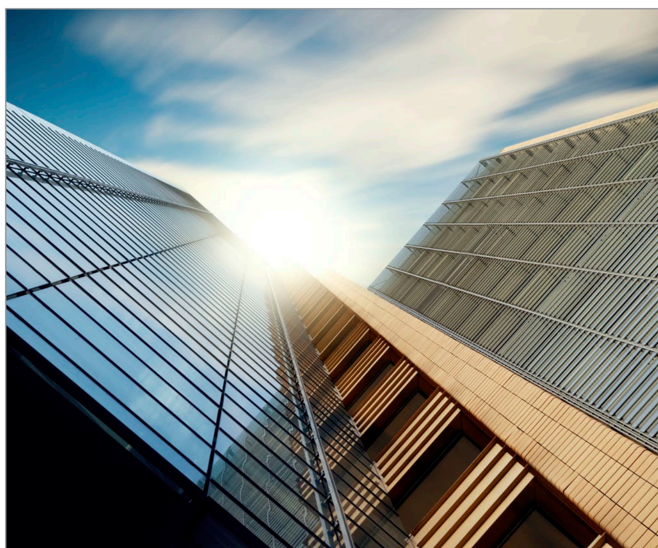

Italy

Italy introduces country-by-country reporting for multinational enterprises

On 22 December 2015, the Italian Parliament approved the Finance Act 2016, which included provisions introducing country-by-country (CbC) reporting for Italian-parented multinational enterprises (MNEs) in line with Action 13 of the OECD's Base Erosion and Profit Shifting (BEPS) project.

An Italian MNE that is required by law to prepare consolidated financial statements, which has consolidated annual revenues of EUR 750 million or more in the taxable year prior to the reporting period, and which is not controlled other than by individuals, must file a CbC report with the Italian tax authorities.

The reporting obligation is extended to subsidiaries resident in Italy which are part of a multinational group that meet the conditions set forth in the law, if the ultimate parent company required to prepare consolidated financial statements is resident in a state that:

- Has not introduced the obligation to file a CbC report or
- Does not have an agreement in force with Italy for the exchange of information related to CbC reporting or
- Fails to fulfil its obligation to exchange information relating to the CbC report

The CbC report must be filed annually and must include specific financial data covering gross profit, taxes paid and accrued and other key indicators of effective economic activities territory by territory.

According to the OECD's recommendations, the first CbC report should cover taxable years beginning after 31 December 2015 and the submission deadline should be either the filing date of the relevant tax return, or 12 months after the end of the reference year (for companies with calendar-year reporting periods, the deadline would be 31 December 2017 for the report relevant to taxable year 2016).

Failure to provide the report or providing an incorrect or incomplete report will trigger penalties ranging from EUR 10 000 to EUR 50 000.

Further details covering the effective date, specific content, filing requirements and methods and other procedural terms and conditions to be followed in relation to CbC reporting will be provided in a Decree to be issued by the Ministry of Economic Affairs and Finance within 90 days of the effective date of the 2016 Finance Act.

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The Netherlands

New decree on transfer-pricing documentation requirements

Introduction

As from 1 January 2016, Netherlands-resident entities (and Netherlands permanent establishments) that are part of a group with a consolidated turnover of at least EUR 50 million are obliged to include a master file and a local file in their administrative documentation. Clearly, existing documentation requirements remain applicable for Netherlands-resident group entities that are part of a group with a consolidated turnover of less than EUR 50 million.

The documentation requirement should be met within the term for corporate income tax returns. Failure to comply may result in administrative penalties and a shift in the burden of proof to the taxpayer.

Additionally, a Netherlands-resident ultimate parent company of a multinational group is obliged to file a country-by-country (CbC) report with the Netherlands tax authorities (DTA) if the total consolidated group turnover is EUR 750 million or more.

In specific cases, this CbC obligation may also extend to a Netherlands-resident group entity that is not the ultimate parent company of the group. This is e.g. the case where the ultimate parent entity is not obliged to file a CbC report in the country of which the ultimate parent entity is a tax resident.

This CbC report has to be filed within 12 months of the reporting year for which the CbC report is filed. The reporting year is the annual reporting period for the commercial accounts of the ultimate parent entity. For example, if the reporting year ends on 31 December 2016, the CbC report has to be filed no later than 31 December 2017.

A group entity that resident in the Netherlands is obliged to notify the tax authorities if it is the ultimate parent entity of the group. If a Netherlands group member is not the ultimate parent entity, it is obliged to disclose the identity and the state of residence of the reporting entity (in most cases this will be the foreign ultimate parent) to the tax authorities before the end of each reporting year.

New decree

On 30 December 2015, the Netherlands Ministry of Finance issued the anticipated decree with more details on the abovementioned additional transfer-pricing requirements. The decree provides detailed rules related to the form and content of these files, which are in line with the requirements as determined by the OECD in BEPS Action 13.

As from tax year 2016, Netherlands master files, local files and country-by-country reports will have to include the information listed below.

Master file

In general, the master file is intended to provide a high-level overview to place the taxpayer's group's (hereafter, the MNE's) transfer-pricing practices in their global economic, legal, financial and tax context.

The master file should provide an overview of the MNE group's business, including the nature of its global business operations, its overall transfer-pricing policies, and its global allocation of income and economic activity. The purpose of the master file is to assist tax administrations in evaluating the presence of significant transfer-pricing risks.

The information required in the master file contains relevant information that can be grouped into five categories and may be drawn up in the Dutch or English language.

1. Organisational structure

A chart illustrating the MNE's legal and ownership structure, as well as the geographical location of operating entities.

2. Description of MNE's business(es)

A general written description of the MNE's business including:

- Important drivers of business profit
- A description of the supply chain for the group's five largest products and/or service offerings by turnover plus any other product and/or services amounting to more than 5% of group turnover. The required description could take the form of a chart or a diagram.
- A list and brief description of important service arrangements between members of the MNE group, other than R&D services, including a description of the capabilities of the principal locations providing important services and transfer-pricing policies for allocating service costs and determining prices to be paid for intra-group services
- A description of the main geographic markets for the group's products and services that are referred to under the second bullet point above
- A brief written functional analysis describing the principal contributions to value creation by individual entities within the group, i.e. key functions performed, important risks assumed, and important assets used
- A description of important business restructuring transactions, acquisitions and divestitures occurring during the fiscal year

3. The MNE's intangibles

- A general description of the MNE's overall strategy for the development, ownership and exploitation of intangibles, including location of principal R&D facilities and location of R&D management
- A list of intangibles or groups of intangibles of the MNE Group that are important for transfer-pricing purposes and which entities legally own them
- A list of important agreements among identified associated enterprises related to intangibles, including cost-contribution arrangements, principal research service agreements and licence agreements
- A general description of the group's transfer-pricing policies related to R&D and intangibles
- A general description of any important transfers of interests in intangibles among associated enterprises during the taxable year concerned, including the entities, countries, and compensation involved

4. The MNE's intra-group financial activities

- A general description of how the group is financed, including important financing arrangements with unrelated lenders
- The identification of any members of the MNE group that provide a central financing function for the group, including the country under whose laws the entity is organised and the place of effective management of such entities
- c. A general description of the MNE's general transfer-pricing policies related to financing arrangements between associated enterprises

5.The MNE's financial and tax positions

- The MNE's annual consolidated financial statement for the fiscal year concerned if otherwise prepared for financial reporting, regulatory, internal management, tax or other purposes.
- A list and brief description of the MNE group's existing unilateral advance pricing agreements (APAs) and other tax rulings relating to the allocation of income among countries

Local file

The local file provides more detailed information relating to specific intra-group transactions of the taxpayer. The local file focuses on information relevant to the transfer-pricing analysis related to transactions taking place between a local country affiliate and associated enterprises in different countries. Further, it helps to substantiate that the transactions in which a Netherlands group company is involved take place under arm's length conditions. The information required in the local file contains relevant information that can be grouped into three categories and may be drawn up in the Dutch or English language.

1. Local entity

- A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices

- A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or transfers of intangibles in the current or immediately past year and an explanation of those aspects of such transactions affecting the local entity
- Key competitors

2. Controlled transactions

For each material category of controlled transactions in which the entity is involved, the following information must be provided:

- A description of the material controlled transactions (e.g. procurement of manufacturing services, purchase of goods, provision of services, loans, financial and performance guarantees, licences of intangibles etc.) and the context in which such transactions take place
- The amount of intra-group payments and receipts for each category of controlled transactions involving the local entity (i.e. payments and receipts for products, services, royalties, interest etc.) broken down by the tax jurisdiction of the foreign payer or recipient
- An identification of associated enterprises involved in each category of controlled transactions, and the relationship amongst them
- Copies of all material intercompany agreements concluded by the local entity
- A detailed comparability and functional analysis of the taxpayer and relevant associated enterprises with respect to each documented category of controlled transactions, including any changes compared to prior years
- An indication of the most appropriate transfer-pricing method with regard to the category of transaction and the reasons for selecting that method
- An indication of which associated enterprise is selected as the tested party, if applicable, and an explanation of the reasons for this selection

- A summary of the important assumptions made in applying the transfer-pricing methodology
- If relevant, an explanation of the reasons for performing a multi-year analysis
- A list and description of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises relied on in the transfer-pricing analysis, including a description of the comparable search methodology and the source of such information
- A description of any comparability adjustments performed, and an indication of whether adjustments have been made to the results of the tested party, the comparable uncontrolled transactions, or both
- A description of the reasons for concluding that relevant transactions were priced on an arm's length basis based on the application of the selected transfer-pricing method
- A summary of financial information used in applying the transfer-pricing methodology
- A copy of existing unilateral and bilateral/multilateral APAs and other tax rulings to which the local tax jurisdiction is not a party and which are related to controlled transactions described above

3. Financial information

- Annual local-entity financial statements for the taxable year concerned. If audited statements exist they should be supplied and if not, existing unaudited statements should be supplied
- Information and allocation schedules showing how the financial data used in applying the transfer-pricing method may be tied to the annual financial statement
- Summary schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained

Country-by-country reporting

The CbC report contains aggregate jurisdiction-wide information related to the global allocation of income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions in which the MNE group operates. The purpose of the CbC report is to enable tax authorities to perform a high-level transfer-pricing risk assessment. The CbC report needs to be filed in XML format.

The information required in the CbC report contains relevant information that can be grouped into two categories and may be drawn up in the Dutch or English language.

1. Overview of allocation of income, taxes and business activities by tax jurisdiction

- Tax jurisdiction
- Revenues – unrelated party
- Revenues – related party
- Profit (loss) before tax
- Tax paid (on cash basis)
- Tax accrued – current year
- Registered share capital
- Accumulated earnings
- Number of employees
- Tangible assets other than cash and cash equivalents

2. List of all the constituent entities of the MNE group included in each aggregation per tax jurisdiction

- Tax jurisdiction
- Constituent entities resident in the tax jurisdiction
- Tax jurisdiction of organisation or incorporation from tax jurisdiction of residence
- Main business activities:
  - Research and development
  - Holding or managing intellectual property
  - Purchasing or procurement
  - Manufacturing or production
  - Sales, marketing or distribution
  - Administrative, management or support services
  - Provision of services to unrelated parties
  - Internal group finance
  - Regulated financial service
  - Insurance
  - Holding shares or other equity instruments
  - Dormant
  - Other

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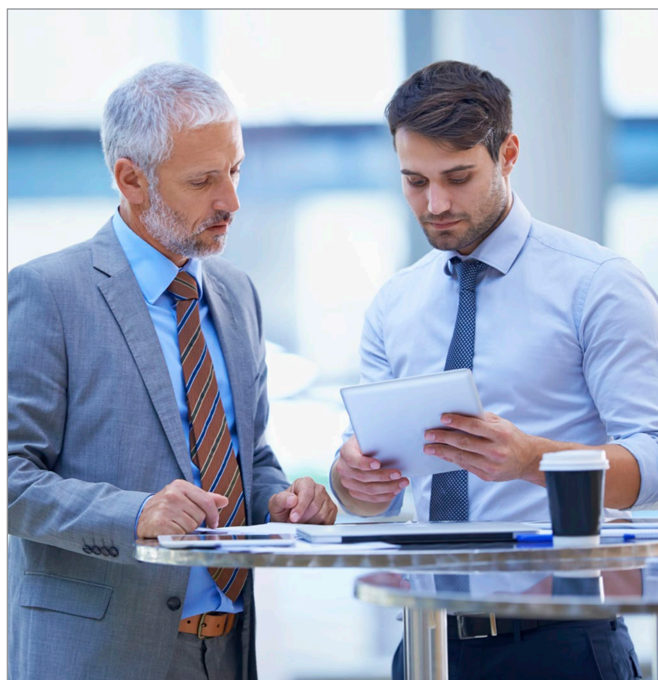

Poland

Who is obliged to have TP documentation?

Currently, until the end of 2016, transfer-pricing (TP) documentation must be prepared and maintained (and produced to the tax authorities on demand) by taxpayers where both the following criteria are satisfied:

- They have carried out a transaction or transactions with a related entity (related by virtue of capital holdings or personal or family relations) or with an entity having its statutory seat, board of directors or place of residence in a jurisdiction that is considered to engage in harmful tax competition
- The value of the transaction exceeds EUR 100 000 in the case of a corporate entity, provided that its value does not exceed 20% of share capital; EUR 30 000 in the case of services or the sale or provision of intangible assets; or EUR 50 000 in all other cases

As from 1 January 2017 TP documentation will be required where:

- The taxpayer's turnover or costs of taxpayer exceeded EUR 2 million in the preceding taxable year and
- The taxpayer's transactions with related entities exceeded a minimum level of EUR 50 000 in that year

Current content requirements

TP documentation should:

- Qualify the functions, risks assumed and the relevant assets of entities participating in the transaction
- Specify the expected costs connected with the transaction along with the form and date of payment
- Detail the method and manner of calculating profits as well as the price of the subject-matter of the transaction
- Define economic strategy
- Indicate other factors influencing the conditions of the transaction
- Describe the expected benefits resulting from a transaction involving intangibles

Preparing a benchmark study (containing comparative data for each kind of transaction) is currently voluntary, but the taxpayer should possess data justifying the applied prices and margins along with the rationale for the chosen pricing methodology.

Changes from January 2017

As from 1 January 2017, TP documentation (the so-called basic version) will have to contain far more detail, e.g.:

- A description of the transactions or other events that have taken place between the taxpayer and related entities, containing:
  - An indication of the type and subject of the transaction
  - Financial data, especially cash flows involved in the transaction
  - Data identifying related entities participating in the transaction
  - A description of the course of the transaction, especially:
    - The functions performed by the taxpayer and related entities
    - The assets and human resources involved in the transaction
    - The risks assumed by taxpayer
  - An indication of the method of calculation the taxpayer's revenue or expenditure on the transaction along with justification of the choice of the particular method, including:
    - An algorithm for calculating the consideration for the transaction
    - The method of calculating amounts resulting from the transaction and having impact on the taxpayer's net revenue or expenditure
- A description of the taxpayer's financial data allowing for comparison between the amounts resulting from the transaction and having an impact on the taxpayer's revenue or expenditure and data resulting from approved financial statements (if the taxpayer is obliged to prepare such statements)
- Information about the taxpayer covering:
  - The taxpayer's organisational and management structure
  - The object and scope of the taxpayer's business
  - The taxpayer's economic strategy, including transfers (between related entities) of economically important assets, functions, or risks affecting the taxpayer's income (loss)
  - The competitive environment.
- Documents, especially:
  - Agreements, contracts concluded between related entities or other documents concerning the transaction
  - Agreements related to income tax matters concluded with the tax authorities of the countries other than Poland involved in the transaction, in particular advanced pricing agreements

Taxpayers with revenues or costs exceeding EUR 10 million will, in addition to the basic version of TP documentation, be obliged to have a so-called comparative analysis (benchmark study). In this document, the taxpayer should prove that the prices applied in the transaction with related entities (margins, profit split) reflect market conditions. The analysis should be based on data from the Polish market. If obtaining such data is impossible, the taxpayer is entitled to rely on data from foreign markets. In each case the taxpayer will have to indicate the source of data used for such a study.

The tax risk connected with lack of TP documentation

On the demand of the tax authorities, taxpayers are obliged to submit TP documentation within seven days of receipt of the demand. Failure to submit TP documentation on time involves a significant tax risk for the taxpayer, i.e:

- The tax authorities may assess the taxpayer's revenue or expenditure from or on the transaction on the basis of market data, which may not be favourable for the taxpayer and will not have regard to the specific nature of the taxpayer's activity
- The tax authorities may impose a 50% tax penalty rate on the difference between the income declared by the taxpayer and that determined by the authorities

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Romania

Changes to transfer-pricing requirements

With effect from 1 January 2016, significant changes with regard to transfer-pricing documentation have been in force in Romania. The new rules are differentiated depending on the category of taxpayer.

Previously, transfer-pricing documentation (TPD) was requested only during a tax inspection, regardless of the category of taxpayer.

Under the new rules, **large taxpayers** are required to prepare their TPD on an annual basis if the transactions undertaken with all affiliated parties are greater than or equal to any of the following thresholds:

- EUR 200 000 for interest received or paid for financial services
- EUR 250 000 for services received or provided
- EUR 350 000 for purchases or sales of tangible or intangible goods

The TPD has to be prepared no later than the due date for filing the annual corporate tax return, namely the 25th day of the third month following the end of the taxable year.

Small, medium and large taxpayers, other than those mentioned above, are required to prepare their TPD only when required to do so by the tax authorities, where the transactions undertaken with all affiliated parties are greater than or equal to any of the following thresholds:

- EUR 50 000 for interest received or paid for financial services
- EUR 50 000 for services received or provided
- EUR 100 000 for purchases or sales of tangible or intangible goods

TPD must be submitted within 30 – 60 calendar days of the date of the request. An extension may be obtained only once, at the written request of the taxpayer, for a period of no more than 30 calendar days.

All the abovementioned thresholds are calculated excluding VAT, taking into account the exchange rate valid for the last day of the taxable year. The taxable year may differ from the calendar year.

Applicability of the new rules

The abovementioned thresholds are taken into account for intragroup transactions undertaken after 31 December 2015.

The rules regarding provision of TPD during a tax inspection are applicable to procedures initiated after 31 December 2015.

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Spain

Changes in Spanish transfer pricing regulations

Simplification for small and medium-sized groups

On 1 January 2015, the coming into effect of the new Corporate Income Tax Act (Law 27/2014) brought with it changes in the Spanish transfer pricing regulations, which were intended to simplify them, especially as regards the documentation obligations for groups with a global consolidated turnover below EUR 45 million.

The principal changes in this connection may be summarised as follows:

- The participation percentage required to consider a shareholder as a related party for transfer-pricing purposes is increased from 5% to 25%
- The preference for the traditional transactional methods (the comparable uncontrolled-price method, the resale-price method and the cost-plus method) versus the transactional profit methods (the transactional net-margin method and the transactional profit-split method) is abolished; all methods now have the same validity. Additionally, where none of these methods is appropriate, other transfer-pricing methods, provided that they observe the arm's length principle, are now acceptable
- Penalties are reduced

Additional obligations for multinational enterprises (MNEs)

At the same time, Royal Decree 634/2015 has introduced a new requirement for MNEs with a global consolidated group turnover exceeding EUR 750 million to file country-by-country reports, with effect for taxable years beginning after 31 December 2015, in accordance with Action 13 of the OECD's Base Erosion and Profit Shifting initiative (BEPS).

As a result of the introduction of CbC reporting and the simplification for smaller groups outlined above, there are now in effect four levels of transfer pricing documentation compliance:

- CbC: mainly applies only where the ultimate parent company of an MNE Group exceeding EUR 750 million of income on a consolidated base is resident in Spain (there are some other specific cases)
- Complete master file + complete local file: for groups with a global consolidated group turnover exceeding EUR 45 million
- Simplified local file: for groups with global consolidated group turnover between EUR 10 million and EUR 45 million
- Super-simplified local file: for groups with a global consolidated group turnover below EUR 10 million

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Slovakia

Interest-limitation rules introduced

Rules limiting the deductibility of interest and associated expenditure on loans provided by related foreign as well as domestic parties were introduced in the Slovak Republic in 2015. No more than an amount of such interest equal to 25% of EBIDTA (earnings before interest, tax, depreciation and amortisation) may be deducted in any taxable year.

The limitation rule does not apply to interest forming part of acquisition costs. Nor does it apply to banks, insurance companies, reinsurance companies, collective investment funds and leasing companies.

Unlike the EBITDA limitation rule in many countries, however, the rule in Slovakia does not apply to loans from unrelated parties.

In addition, from 1 January 2015, transfer pricing rules apply to transactions between both domestic and foreign related parties. All controlled transactions should comply with the arm's length principle; there is no *de minimis* exemption.

Supreme Court rules on transfer-pricing adjustments

The Supreme Court of the Slovak Republic (*Najvyšší Súd*) has reversed a lower court's decision to uphold a reduction by 50% of the deduction claimed by a Slovak company in respect of payments to its Austrian parent company for intra-group services in a transfer-pricing dispute.

The case involved a Slovak subsidiary (Coca Cola HBC Slovenská Republika s.r.o.) of Coca Cola Austria. Following a tax audit in 2012 of the subsidiary's tax return for 2004, the Slovak tax authorities reduced the subsidiary's allowable tax loss from the amount of SKK 41 million to SKK 16 million. The subsidiary appealed against the decision to the Regional Court of Bratislava. This court upheld the assessment and the subsidiary then appealed further to the Supreme Court. Finally, on 19 November 2015, the Supreme Court overturned the Regional Court's decision and overturned the assessment, but on the grounds that it was out of time.

The crux of the dispute was the magnitude of the management fees paid for consultancy, law, accounting and data-processing services provided by the subsidiary's parent company in Austria. On the basis of the documents provided by the subsidiary, the tax authorities found that it was not possible to identify clearly which operating costs were included in the cost pool of the Austrian parent company. In addition, it was not clear enough whether identical services were also provided to the subsidiary by a third party. As a result, the tax authorities disallowed 50% of the payments made for these intercompany services, finding them to be insufficiently proven for tax purposes under section 21 of the Income Tax Act.

The issue before the Supreme Court turned more on the national statute of limitations rather than on the factual background. The tax authorities pointed out that if the adjustment was made under the provisions of an international tax treaty, the statute of limitations is 10 years, as opposed to five years for purely domestic matters. The tax authorities also made reference to article 9 of the double tax treaty between the Slovak Republic and Austria, which provides that prices fixed between associated companies should be in conformity with the arm's length principle.

However, the Slovak Supreme Court ruled that although reference had been made to the tax treaty before the courts, the transfer-pricing adjustment had in fact been made by reference to domestic tax legislation. Since the statute of limitations in such a case is five years, the tax authorities' assessment had been out of time.

Moreover, the Supreme Court also observed that the Commentary to the Model Tax Convention OECD and the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations are only indicative and not legally binding under Slovak law as they are not reproduced in statute.

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Sweden

Sweden proposes to adapt existing legislation to BEPS and to Directive 2011/16/EU

Requirements on transfer-pricing documentation were implemented in Sweden on 1 January 2007, but with BEPS and new directives from the EU on transfer-pricing documentation the law will probably change from 1 January 2017, from which date the new rules will most likely take effect.

Changed rules on who is required to produce transfer-pricing documentation

In addition to adjustments to the BEPS-inspired documentation requirements, the law will now be extended to include foreign companies with permanent establishments in Sweden and Swedish partnerships (*Handelsbolag*). It now, however, excludes small and medium-sized enterprises from all documentation requirements and is only applicable to companies according to the following definition:

- Companies that are members of a group that have more than 250 employees or
- Companies that are members of a group that have fewer than 250 employees but either have a turnover exceeding SEK 450 million, or a balance-sheet total exceeding SEK 400 million.

For transactions below SEK 5 million there will be no documentation required.

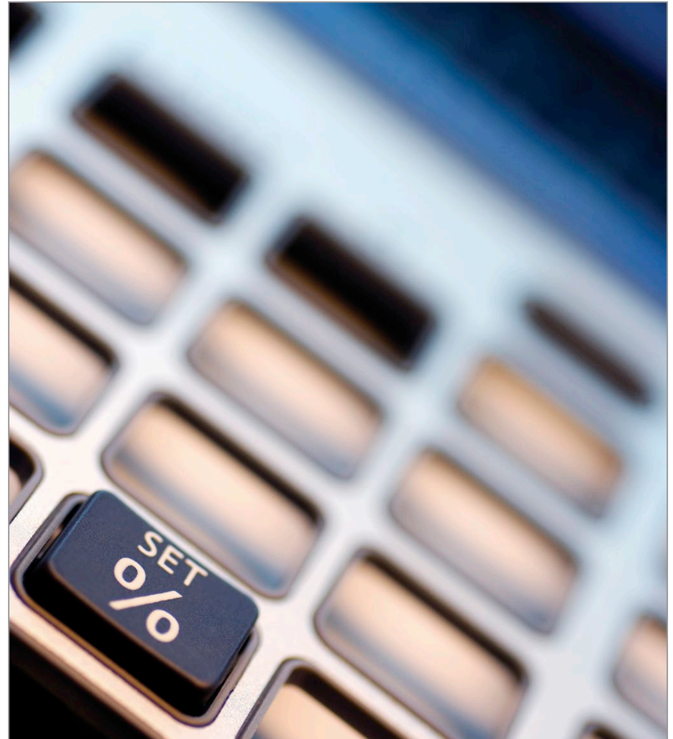
Master file/local file

A master file must be drawn up for the group and all its activities. It needs to include an overview of the group and, for example, include the following information:

- Important factors affecting profit generation
- A description of the group's most traded products
- Major geographic markets
- A description of important corporate service functions
- Details of intangible assets

A local file needs to be created for each legal entity in the group and the focus is on this individual legal entity's activities. It must include detailed information such as the following:

- The legal entity's management structure
- The business strategy of the legal entity
- Intragroup transactions that the legal entity has undertaken during the tax year
- Detailed functional and comparability analysis and the applied pricing method for the transactions



Country-by-Country reporting

A group must submit a country-by-country report to the tax authorities, which should include, for example, the following information for each country where the group operates:

- Information about revenues for each country
- Profit before tax for each country
- Income tax paid for each country
- Number of employees and tangible assets for each country

Comments

For companies or subsidiaries that are part of a group covered by the new rules work should begin now to adapt their current transfer-pricing documentation and their reporting system to meet the future transfer pricing-documentation requirements and country-by-country filing requirements.

For groups that fall outside the documentation requirement, 'fair market value' rules still apply to intragroup transactions. We therefore recommend that groups and their separate legal entities nonetheless have a documented transfer-pricing policy to be able to show that the intragroup transactions are made at fair market value.

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United Kingdom

Interpretation of TP legislation to incorporate BEPS changes

HMRC (the United Kingdom's tax authority) announced on 28 July 2016 that, when interpreting the United Kingdom's transfer pricing legislation with respect to accounting periods beginning after 31 March 2016 (or, in the case of income tax, with respect to tax years 2016-17 onwards), it would have reference to the OECD's 2010 Guidelines as amended by the BEPS Final Report on Actions 8-10 published by the OECD on 5 October 2015.

In interpreting TP legislation, HMRC is bound by law to be consistent with Article 9 of the OECD Model Convention and the OECD Transfer Pricing Guidelines.

Country-by-Country Reporting

Finance Act 2015, section 122 gives Her Majesty's Treasury the power to make regulations requiring MNEs to provide HMRC with a country-by-country report. The relevant regulations (The Taxes (Base Erosion and Profit Shifting) (Country-by-Country Reporting) Regulations 2016 No 237) have been enacted and take effect with respect to accounting periods beginning after 31 December 2015 (hence, first for the 2016 accounting period for companies with calendar-year ends).

Any ultimate parent entity of an MNE with a consolidated group turnover of EUR 750 million (approximately GBP 636 million at late-November 2016 exchange rates) will be required to file a CbC report within 12 months of the end of the accounting period to which the report relates. The requirement also extends to the uppermost UK entity within an MNE whose ultimate parent entity is resident in a jurisdiction that neither imposes a CbC requirement nor exchanges reports with HMRC in accordance with an effective multilateral competent-authority agreement.

The precise form and content of a CbC report has yet to be prescribed by regulations, but the governing legislation makes specific reference to the OECD's Guidance on Transfer Pricing Documentation and Country by Country Reporting, they are likely closely to match that model.

Failure to file a CbC report on time incurs a penalty of GBP 300 (approx. EUR 354) plus a daily penalty of GBP 60 (approx. EUR 71) for each day the default continues once the initial penalty has been assessed. The provision of incorrect information incurs a penalty of up to GBP 3000 (approx. EUR 3535).

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