

### OCTOBER 2017 ISSUE 25 WWW.BDO.GLOBAL

# **TRANSFER PRICING NEWS**

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## INTRODUCTION

ransfer pricing is increasingly influencing significant changes in tax legislation around the world. This 25th issue of BDO's Transfer Pricing Newsletter focuses on recent developments in the field of transfer pricing in Cyprus, Germany, India, Spain, Switzerland and the United Kingdom. As you can read, major changes in legislation will be made in the coming period and interesting developments occur in various countries around the world.

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

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# CYPRUS TAX UPDATE

n 30 June 2017, the Cypriot Tax Department issued an interpretative circular setting out the revised tax treatment of intra-group back to back financing arrangements, effective from 1 July 2017.

The new tax treatment is applicable for companies which:

- Carry out intra-group financing transactions; and
- Are Cyprus tax resident companies or are non-Cypriot tax resident companies which have a permanent establishment (PE) in Cyprus and the financing activities are attributable to the PE.

The term 'intra-group financing transaction' refers to any activity consisting of granting loans or cash advances remunerated by interest (or which should be remunerated by interest) to related companies, financed by financial means and instruments, such as debentures, private loans, cash advances and bank loans.

## 1. Application of arm's length principle to intra-group financing transactions

It is necessary to determine for each intragroup financing transaction conducted, as with all types of intra-group transactions, whether the agreed remuneration complies with the arm's length principle (as set out in Article 9 of the OECD Model Tax Convention on Income and on Capital) i.e. whether it corresponds to the price which would have been accepted by independent entities in comparable circumstances, taking into account the economic nature of the transaction.

## 2. Comparability analysis (transfer pricing study)

An appropriate comparability analysis (transfer pricing report) must be carried out in order to determine whether transactions between independent entities are comparable to transactions between related entities. The comparability analysis should consist of two parts:

- Identification of commercial or financial relationship between related entities and determination of the conditions and economically relevant circumstances attaching to those relations;
- Comparison of the accurately delineated conditions and economically relevant circumstances of the controlled transaction with those of comparable transactions between independent entities.

### 3. Substance requirements

In order to justify the risk control and to further validate that the management and control are exercised in Cyprus it is imperative that the group financing company must have an actual presence in Cyprus. In this regard the following will be taken into account:

- The number of the members of the board of directors who are tax resident in Cyprus;
- The number of meetings of the board of directors taking place in Cyprus; and
- The availability of qualified personnel to control the transactions performed.

Nonetheless the group financing company may subcontract functions which do not have a significant impact on risk control.

### 4. Simplification measures

When a Cyprus tax resident group financing company pursuing a purely intermediary activity grants loans or advances to related companies, which are refinanced by loans or advances obtained from related companies, it is considered for the sake of simplification, that the transactions are deemed to comply with the arm's length principle, if the company receives a minimum after tax return of 2% on the assets. This percentage will be regularly reviewed by the Tax Department, based on relevant market analyses. In such case no transfer pricing study will be required.

In order to benefit from this simplification measure, entities should:

- a. Satisfy the minimum substance requirements mentioned in Section 3;
- b. Communicate to the Tax department the use of the simplification procedure, by completing the relevant field in the tax return of the corresponding fiscal year.

It should be noted that:

- Any deviation from the minimum return of 2% is not allowed unless in exceptional cases it is duly justified by an appropriate transfer pricing analysis;
- This minimum return percentage cannot be used, without a transfer pricing analysis, to determine arm's length remuneration for intra-group financing transactions different from those covered by the circular.

## 5. Minimum requirements for transfer pricing analysis

The minimum requirements for the transfer pricing analysis are those that are set out in Paragraph 29 of the relevant circular.

The Transfer Pricing Analysis should be prepared by a Transfer Pricing Expert.

It must be submitted to the Cyprus Tax Department by a person who has licence to act as auditor of a company in Cyprus, who is required to carry an assurance control of the transfer pricing analysis.

### 6. Exchange of information

The issue of tax rulings (including rulings related to simplification measures) or Advanced Pricing Arrangements, as well as the use by a taxpayer of the simplification measures, whether applied following the issue of a ruling or not, are subject to the exchange of information rules set under the Directive on Administrative Cooperation (Council Directive (EU) 2011/16 as amended by Council Directive (EU) 2015/2376).

### 7. Entering into force of the circular

The new circular applies with effect from 1 July 2017, for existing and future transactions, irrespective of the date of entering into the relevant transactions and irrespective of any tax rulings issued prior to that date.

Any tax rulings issued prior to 1 July 2017 on transactions within the scope of the relevant circular will no longer be valid for tax periods from 1 July 2017.

If the intra-group financing transactions effected prior to 1 July 2017 are still ongoing post the reference date and they were supported by a transfer pricing study, the said transfer pricing study will need to comply with the provisions of the relevant circular, which will be verified by the Tax Commissioner.

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## **GERMANY** INTRODUCING A ROYALTY BARRIER RULE

number of countries grant tax advantages for the development and/ or the exploitation of intellectual property. Currently, there are about a dozen countries in Europe with so-called 'IP Box Regimes'.<sup>1</sup> Such preferential regimes can be used by multinational groups for profit shifting. Under Action 5 of the Base Erosion and Profit Shifting project (BEPS) the OECD and G20 countries developed a framework to combat harmful tax practices.<sup>2</sup> As a result, the 'Law against Harmful Tax Practices in Connection with the Assignment of Rights' ('Gesetz gegen schädliche Steuerpraktiken im Zusammenhang mit Rechteüberlassung') was adopted on 27 June 2017 (German Federal Law Gazette I pg. 2074, hereinafter 'the Law').



### Subject matter

The Law pursues two objectives: Firstly, to limit the tax deductibility of expenses for the assignment of rights in order to prevent royalty income from not being taxed or taxed at a low rate; and secondly, to tax income in the country where value is created. For this purpose Section 4j German Income Tax Act (EStG) was introduced to override existing bilateral tax treaties. The new rule restricts the deduction of expenses for the assignment of rights, if all of the following cumulative requirements are met:

- Royalty income for the assignment of rights is subject to low taxation which differs from standard taxation in the recipient's country (preferential regime); and
- The licensor is a related party to the licensee within the meaning of Section 1 Paragraph 2 German Foreign Tax Act (AStG).

'Low taxation' means that taxation differs from standard taxation and leads to an income tax burden of less than 25%.

If all requirements mentioned above are cumulatively met, the expenses are not (or only partially) tax deductible. The non-deductible part of these expenses is calculated according to the following formula:

> (25% - income tax burden in %) 25%

This rule also applies to intermediate companies and/or permanent establishments.

The so-called royalty barrier does not apply if low taxation is the result of a preferential regime of the licensor's income that follows the Nexus Approach according to Chapter 4 of the OECD's Action 5 final report. The Nexus Approach allows taxpayers to apply preferential regimes if they conduct research and development themselves. Exceptions to this rule are trade mark rights that consequently are always subject to the license barrier rule. Section 4j EStG enters into effect for expenses for the assignment of rights that occur after 31 December 2017.

### Assessment

Conflicts with tax authorities seem inevitable due to the lack of a clear statutory definition of the term 'standard taxation' and due to mere references to the OECD's nexus approach. It can be suspected that the rigid marginal tax rate of 25% may in cases where the licensor country's tax rates are lower lead to overcompensation within the group and, thus, to factual double taxation.<sup>3</sup> The relationship between the royalty barrier rule and the anti-abuse rule according to Section 50d Paragraph 3 EStG (final deduction of 15% withholding tax if the licensor lacks substance) is unclear. Last, but not least, it seems that the taxpayer has to bear the burden of proof for the tax treatment of royalty payments received abroad, which will trigger higher tax compliance expenses.

### Royalty barrier and transfer pricing

Despite all the above, it is necessary to ensure that agreed royalty rates are at arm's length, as the application of the royalty barrier does not result in the exclusion of transfer pricing adjustments. For example, if a German affiliate pays royalties to its overseas ultimate parent entity that are not at arm's length, it is likely a constructive dividend according to Section 8 Paragraph 3 Sentence 2 German Corporation Income Tax Act will be assumed. For calculating the amount of non-deductible royalties it is our understanding that an arm's length royalty payment has to be considered.

As transfer pricing adjustments are not excluded due to the introduction of the royalty barrier, multinational enterprises are well advised to pay attention to and document the arm's-length nature of cross-border intragroup royalties.

### Effective support from BDO

The international tax services department of BDO would be pleased to support you in planning and applying a transfer pricing system as well as fulfilling your statutory cooperation obligation regarding transfer pricing documentation. If required, we cooperate with colleagues from our international network in over 150 countries.

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- <sup>1</sup> See. Page 63 OECD (2015), Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.
- <sup>2</sup> Further information see Footnote 1.
- <sup>3</sup> See. Schneider/Junior DStR 2017, page 417 (421).

## **INDIA** REVISED SAFE HARBOUR NORMS

he Safe Harbour Rules were formulated by the Indian tax administration body – the Central Board of Direct Taxes (CBDT) – in 2013 as a mechanism to avoid increasing transfer pricing disputes. As the margins/benchmarks prescribed for specified transactions were high and were not aligned with the industry/economic standards, the safe-harbour regime received a tepid response from taxpayers.

As part of the Government's stated intent of reducing transfer pricing litigation, the CBDT has recently announced revised safe harbour norms for small and medium size transaction amounts (INR 1,000/2,000 million) of specified categories. The revised rules will apply for fiscal year 2016-17 and the subsequent two fiscal years. It is provided that taxpayers eligible under the old regime may choose the safe harbour option that is more beneficial to them.

The revised safe harbour provisions and a comparative analysis of benchmarks are summarised below:

### New eligible transaction

In line with the recommendation of BEPS Action Plan 10, safe harbours have been introduced for the availing of low value adding intra-group services. Such services include support services, not forming part of the core business of the taxpayer and not in the nature of shareholder or duplicative services. Safe harbours are available only where such low value adding services do not exceed INR 100 million (including a mark-up of 5%). The regulations require the Indian entity to obtain a certificate from an accountant confirming the method adopted for cost pooling, fairness of the allocation keys and certification that the cost base does not include shareholder cost or duplicative cost.

### **INTEREST ON SECONDARY ADJUSTMENT**

The Finance Act 2017 introduced the concept of a secondary adjustment in the Indian transfer pricing regulations. A secondary adjustment is to be carried out where a primary adjustment (in specified cases/ situations) results in an increase in taxable income (or reduction in loss) of a taxpayer and the excess money available with the associated enterprise (AE) is not repatriated into India within the prescribed time limit. In such cases, the excess money is deemed an advance to the AE and interest is imputed on such amount.

To implement these provisions, the CBDT has now announced the time limit and manner of computation of interest as below:

- Time limit A secondary adjustment is to be made where excess amounts are not repatriated into India within 90 days from the due date of the tax return or the date ordered by the tax authorities, depending upon the event of the primary adjustment;
- Interest In secondary adjustment cases, interest is to be imputed at the State Bank of India/LIBOR lending rate depending upon the currency of transaction (Indian/foreign), with specified additional basis points.

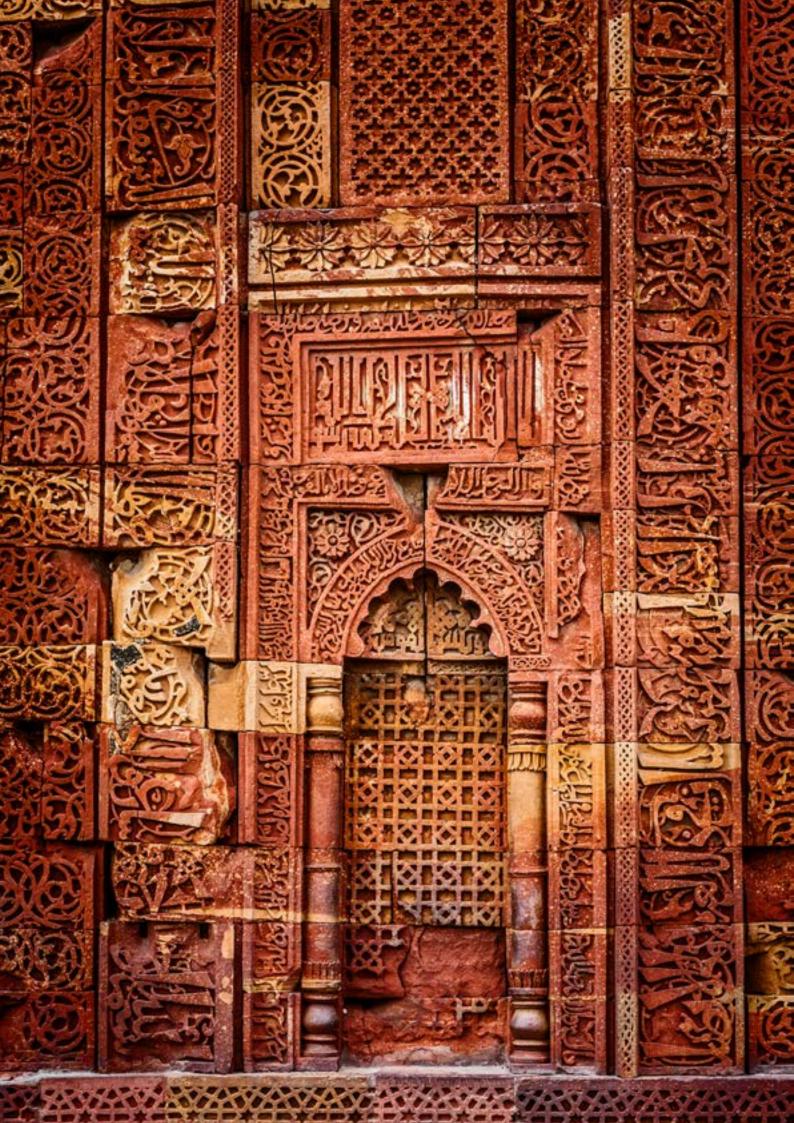
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Category	Old benchmark	Revised benchmark
Provision of software development services and ITeS with insignificant risks	20% to 22% on operating cost	17% to 18% on operating cost
Provision of knowledge processes outsourcing services <b>with insignificant risks</b>	25% on operating cost	18% to 24% on operating cost (depending upon employee cost to total cost ratio)
Provision of contract R&D services relating to software development <b>with insignificant risks</b>	30% on operating cost	24% on operating cost
Provision of contract R&D services relating to generic pharmaceutical drugs with insignificant risks	29% on operating cost	24% on operating cost
Advancing of intra-group loan to a non-resident wholly owned subsidiary in Indian currency	State Bank of India (SBI) base lending rate as on 30 June of the fiscal year plus 150 to 300 basis points (bp)	SBI lending rate based on marginal cost of fund as on 1 April of the fiscal year plus 175 bp to 625 bp depending upon credit rating
Advancing of intra-group loan to a non-resident wholly owned subsidiary in foreign currency	SBI base lending rate as on 30 June of the fiscal year plus 150 to 300 basis points (bp)	Six Month LIBOR as on 30 September of the fiscal year plus 150 bp to 600 bp depending upon credit rating
Providing explicit corporate guarantee to wholly owned subsidiary	1.75% to 2% of the amount guaranteed	1% of the amount guaranteed



## **SPAIN**

### NEW FORM FOR INFORMATION REQUIREMENTS OF RELATED ENTITIES

n 30 August 2017, the 'Order HFP/816/2017 of 28 August, approving Form no. 232 (hereinafter, 'the Form') of informative transactions carried out between related parties and transactions and situations related to countries or territories regarded as tax havens (hereinafter 'the Order')', was published in the Official State Gazette.

### Aim of the order

The aim of the Order is to transfer the information on transactions carried out between related parties contained on page 20 of the Corporate Income Tax return (Tax return no. 200) to a new information form in which those transactions are expressly included.

In addition, this Form will gather information on the specific related operations described in the Corporate Income Tax Law, on the operations to which the reduction of income from certain intangible assets is applied (§23 CITL), and finally to detail operations carried out with entities located in tax havens, whether related or not.

### **Filing requirements**

The Order confirms most of the issues set out in the Draft published by the Tax Agency last April. However, it should be mentioned that it has undergone some modifications, the most relevant of which relates to the deadline for submission of the Form. It must be filed during the month following the ten months after the end of the tax period to which the information relates. In other words, entities whose fiscal year ends on 31 December must file the Form between 1 and 30 November 2017.

On the other hand, it is established that only taxpayers subject to Corporate Income Tax and Non-Resident Income Tax who are acting through a permanent establishment (PE) are obliged to file the Form, as well as entities with attribution of income constituted abroad with presence in the Spanish territory. Certain modifications were also made to clarify the information to be included in the Form.

Accordingly, Corporate Income Tax taxpayers and PEs subject to the Non-Residents' Income Tax are obliged to file the Form and declare certain information on the following transactions with related parties:

- Transactions undertaken with the same related party, provided that the amount of the consideration of the group of transactions exceeds EUR 250,000, in accordance with the market value;
- Certain specific transactions contained in the §18.3 CITL, provided that the total amount of each of the transactions of this type in the tax period exceeds EUR 100,000.

However, there will be no requirement to declare information on transactions with related persons or companies in the Form for transactions carried out:

- Between companies which belong to a tax consolidation group;
- With members or other companies which take part in the same economic interest groupings and temporary joint ventures, with certain exceptions;
- As part of an initial public offering or public takeover bid on shares.

Nevertheless, regardless of the amount of group transactions undertaken with the same related person or company, the Form must be filed with the information on transactions carried out between related parties regarding those transactions of the same nature which use the same valuation method, provided that the amount of this group of transactions in the tax period is higher than 50% of the company's turnover.

### Information to be included in the Form

The information that should be included in this Form is as follows:

- a. The tax identification number of the related person or company;
- b. Whether the related person or company is a physical, legal or other person;
- c. The surnames and name of the related person or the company name;
- d. The type of relationship according to the §18.2 CITL;
- e. The Spanish provincial code or the country of residence of the related party;
- f. The type of transaction included in the §18.2 CITL. It should be pointed out whether it is income or a payment, depending upon the nature of the transaction;
- g. The valuation method applied;
- h. The amount excluding VAT (in EUR).

Furthermore, the Form should also be filed when taxpayers are involved in the following scenarios:

- Transactions with related persons or companies, if the reduction of the income generated from certain intangible assets is applied under the Spanish patent box regime;
- Transactions and situations related to countries or territories regarded as tax havens.

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## **SWITZERLAND** UPDATE ON THE SWISS CORPORATE TAX REFORM

### **Corporate Tax Reform III rejected**

n February 2017, the Swiss people voted against 'Corporate Tax Reform III' (CTR III). Only 40.9% of the Swiss voters and only 3.5 (of 26) states approved the very complex proposal which should ensure that the Swiss corporate tax system remains in line with OECD expectations and competitive at the same time. After this rejection of the first proposal for a corporate tax reform, the Swiss Federal Council started a new process and defined the main details of a new proposal (called Tax Proposal 17 or TP 17).

Based on several hearings with various representations of interests, the Swiss Federal Council published a balanced new proposal which is currently under consultation, so that the Swiss parliament can decide on the new proposal in Summer/Autumn 2018. This seems to be reasonable, because proponents and opponents of CTR III agree that the existing tax privileges for certain companies (holding, principal, mixed companies, etc.) should be abolished in order to be compliant with international standards. Therefore, a new proposal should be implemented in January 2019 in order to fulfil the promises made to the OECD and EU.

### New proposal

Basically, the new proposal should consider the following main aspects:

- Strengthening Switzerland's competitiveness and attractiveness with regard to taxes;
- Obtaining international acceptance (mainly by abolishing the current tax privileges);
- Protecting tax revenues at a federal, cantonal and communal level.

In order to maintain these guidelines, the new proposal will include measures which are more restrictive and more precisely described than the measures in CTR III. On one hand this means that the cantons might have less flexibility for the adoption of the different measures, and on the other hand all cantons should publish their plans for the implementation of the measures before the decision on TP 17 is made.

The key elements of the proposal prepared by the Federal Council are as follows:

- Implementation of a mandatory patent box in accordance with the OECD standard at the cantonal level;
- Introduction of a super deduction for R&D costs which is limited to 50% of the actual costs at the cantonal level. The definition of R&D costs is quite limited (mainly personnel expenses);
- The tax relief on profits arising from the two aforementioned instruments may not exceed 70% (the limitation amounted to 80% in CTR III);
- The partial taxation of dividends from qualified participations should be 70% at federal level and at least 70% at cantonal and communal level (currently several cantons have lower ceilings);
- The cantons will receive 20.5% of direct federal tax revenue instead of 17%.
  Furthermore, it is mentioned that the cantons should share this amount with the communes.

If the cantons are able to keep track, it could be possible to implement the new corporate tax law by January 2019 at a federal level and after a two year transition period at the cantonal and communal level.

#### Conclusion

Based on this proposal, it is highly recommended that companies should analyse the new situation. Furthermore it is important to keep in mind that Switzerland agreed to exchange tax rulings if they remain valid as at 1 January 2018. Therefore, it is necessary to assess whether it could be an option to keep current tax privileges without a ruling (the privileges are explicitly governed by cantonal tax law) or whether a company should waive its status and apply for a step-up of its hidden reserves.

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### UNITED KINGDOM HMRC PUBLISHES GUIDANCE ON COUNTRY-BY-COUNTRY REPORTING

he UK's regulations implementing the OECD model for Country-by-Country (CbC) reporting came into force for periods starting on or after 1 January 2016. HMRC published its CbC reporting guidance in August 2017, and we summarise some of the

### UK rules are based on OECD guidance

The UK rules use many terms and definitions that are taken from the **OECD guidance**, and HMRC states that that guidance should be checked when completing a CbC report.

Reports must be made in the XML format agreed at the OECD and which is acceptable for the EU.

### **Required information**

main points below.

For each territory where the group has a taxable presence, businesses must provide the following information annually:

- Revenues, split between related and unrelated parties
- Earnings before income tax (but after expenses and exceptional items)
- Income taxes paid on both a cash and accrued basis (to local and other countries), including withholding tax
- Stated capital and accumulated earnings
- Number of local employees
- Tangible assets (but not cash or equivalents)
- The local Tax Identification Number for each entity.

### Data used when completing reports

HMRC states that in general when completing the CbC report, the data should be drawn from consistent sources each year. HMRC does not specify which data sources should be used, but these can include consolidation reporting packages, separate entity statutory financial statements, regulatory financial statements or internal management accounts.

In practice, the choice for businesses is whether to prepare data on a 'top down' basis from the filed accounts, or 'bottom up' using management reporting data. This is a policy question which businesses should address at the start of their reporting process.

### **Notification requirements**

Ultimate parent entities (UPEs) and United Kingdom entities (UKEs) are required to notify HMRC for each period covered by a CbC report. HMRC seeks the following information in the notification:

- Which entity (including the unique taxpayer reference or equivalent) in the MNE group will file the CbC report and where;
- Whether exception A or B applies (see below); and
- The names and unique taxpayer references of all of the MNE group's entities that are tax resident in the UK, are UK permanent establishments of overseas group entities or are UK partnerships.

To avoid duplication, UPEs and UKEs will not have to notify if another UPE or UKE of the MNE group has provided a notification which contains all the information that would have been required and it has provided HMRC with the identity of the UPE or UKE that has notified and the date that took place by the deadline. Where there are multiple UPEs or UKEs needing to provide notification, HMRC will accept a notification submitted by one of the UPEs or UKEs as long as it is clear it is sent on behalf of all the relevant entities.

## Notification – Groups wishing to apply a permitted exception

A UK entity can apply an exception where the information it would be required to file has already been included in either:

- A CbC report which has already been received by HMRC (Exception A); or
- A CbC report filed with a jurisdiction that will exchange with HMRC (Exception B). It is not necessary for the CbC report to have been received by HMRC from the other jurisdiction for the exception to apply but it is necessary for the report to have been filed with the tax authority of the other jurisdiction before the filing deadline.

An entity which is applying either of the exceptions must tell HMRC, by the filing deadline:

- Which entity in the MNE group has filed the CbC report; and
- The date the report was filed.

Additionally for Exception B to apply the UK entity must also tell HMRC:

- Which jurisdiction the entity that filed the report is resident in; and
- The jurisdiction in which the report was filed.

HMRC would prefer UK entities that are applying either exception to notify it by email to **notification.cbcrfiling@hmrc.gsi.gov.uk**, or by post to:

HMRC CbCR Notifications Room 806 8<sup>th</sup> Floor Dorset House Stamford Street London SE1 9PY

### Provision of information by parent entities

Where a top UK entity of a non-UK headed MNE group is required to file a CbC report, it must request the information it would need to file a CbC report for the whole group from its non-UK parent entity. If it receives the information it must file the CbC report by the deadline.

If the parent entity does not provide the information then the UK entity must notify HMRC in writing that the parent has not provided the information and the entity must file a UK CbC report by the deadline.

### Countries with which the UK will exchange CbC reports

The UK will exchange CbC reports with countries in the OECD's list of Country-by-Country exchange relationships.

There are currently no countries where HMRC has determined that exchange arrangements are not working effectively.

### HMRC's use of CbC reports

HMRC will use CbC reports within its risk assessment process for cross border transactions, principally between members of multinational groups.

CbC reporting data received by HMRC under an international agreement from another tax authority is subject to conditions of use set by that agreement. The data will be clearly marked where that is the case and resulting conditions must be met.

The agreement under which HMRC has obtained the report requires HMRC to use the data for the following purposes only:

- High level transfer pricing risk assessment;
- Assessment of other base erosion and profit shifting related risks; and
- Economic and statistical analysis, where appropriate.

In addition, HMRC has agreed not to use CbC reporting data as a substitute for a detailed transfer pricing analysis of individual transactions and prices based on a full functional analysis and a full comparability analysis.

The information in the CbC Report on its own does not constitute conclusive evidence that transfer prices are or are not appropriate, and further details, information and documents will always need to be considered in order to substantiate any risk indicated by the report.

### **Documentation requirements**

HMRC requires that transfer pricing documentation should be retained to support the arms-length pricing. Such documentation should be proportionate to the size and complexity of the transactions or business involved and should be the same as that specified in Annexes I and II of the OECD's BEPS Action 13 report. HMRC does not require a master file or local file to be filed with the CbC return.

### BDO's XML tagging and filing solution

BDO can manage XML tagging and filing requirements for CBC reporting, using a template fully aligned to HMRC's XML schema, to ensure that CBC XML files will be accepted first time around by HMRC.

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### **CURRENCY COMPARISON TABLE**

The table below shows comparative exchange rates against the euro and the US dollar for the currencies mentioned in this issue, as at 20 October 2017.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Indian Rupee (INR)	0.01535	0.01298
Euro (EUR)	1.00000	1.18231

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