

# TRANSFER PRICING NEWS

## INDIA

Concept of Secondary Adjustment and CbCR introduced

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## ITALY AND THE NETHERLANDS

New transfer pricing decrees provide a interpretation of the arm's length-principle

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Three-tiered approach to transfer pricing documentation adopted

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## INTRODUCTION

**T**ransfer pricing is increasingly influencing significant changes in tax legislation around the world. This 28<sup>th</sup> issue of BDO's Transfer Pricing Newsletter focuses on recent developments in the field of transfer pricing in India, Israel, Italy, The Netherlands, Peru, and the United Kingdom. As you can read, major changes in legislation have been made and will be made in the coming period, with interesting developments 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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# INDIA

## RECENT DEVELOPMENTS

### Secondary Adjustment – Time limit for repatriation of excess money to India

The Indian tax law introduced the concept of Secondary Adjustment with effect from fiscal year 2017-18. The provisions require the taxpayer to give effect to primary adjustment in its books of account and the books of associated enterprises (AE) to reflect the accounts payable/receivable consistent with the arm's length pricing principle. The provisions also mandate repatriation to India of excess money available with AE on account of primary adjustment, within a specified time limit. Failing this, interest income is imputed assuming such amounts to be overdue from the AE.

For cases of primary adjustment arising on account of an Advance Pricing Agreement (APA) entered into by the taxpayer or an agreement reached under the Mutual Agreement Procedure (MAP), the Rules provided a time limit of 90 days from the due date of filing the tax return for repatriation of the adjustment amount. Compliance with this time limit raised the following difficulties:

- APA cases – 90 days limit ending on a date before APA was signed

[say APA for fiscal year 2016-17 was entered into in May 2018, but time limit for repatriation ended in February 2018 (i.e. 90 days from due date of filing tax return November 2017)]

- MAP cases – 90 days limit ending on a date prior to giving effect of MAP resolution

[say MAP resolution for fiscal year 2016-17 accepted and given effect to by tax officer in August 2020 (i.e. 90 days from date of communication of resolution arrived under MAP) but time limit for repatriation ended on February 2018]

To rectify such anomalies, a draft modification to the above rules has been released for public comments by the Tax Administration. The revised time limits proposed for repatriation are:

- Where primary adjustment is determined by APA – 90 days from date on which the APA has been entered into by the taxpayer;
- Where primary adjustment is determined by MAP – 90 days from date of giving effect by tax officer to the MAP resolution.

**[F. No. 370142/12/2017-TPL dated 19 June 2018]**

### Disclosures pertaining to Secondary Adjustment and Country-by-Country Report (CbCR) in tax audit reporting

Taxpayers with gross receipts or turnover exceeding INR 10 million for businesses and INR 5 million for professions are required to get the books of accounts audited and furnish an accountants tax audit report. The contents of this tax audit report now require details of secondary adjustment and CbCR filing as follows:

- Regarding secondary adjustment
  - Primary adjustment made during the relevant assessment year;
  - Whether any excess money is to be repatriated to India and this is repatriated within the prescribed time limit;
  - If not, the interest income attributable to such excess money.
- Regarding CbCR
  - Whether the taxpayer, parent entity or alternate reporting entity is liable to furnish a CbCR report and if so, which entity has filed such report;
  - Name of parent entity, alternate reporting entity (if applicable) and date of furnishing report.

**[Notification G.S.R. 666(E) dated 20 July 2018]**

### High Court dismisses appeal pertaining to appropriateness of comparables and filters used in transfer pricing analysis where no 'substantial question of law'

Section 260A of the Income Tax Act provides for an appeal to the third level appellate authority – i.e. High Court (penultimate court of justice) against an order passed by the second appellate authority i.e. Tax Tribunal. However, only appeals involving a substantial question of law (not a question on facts) are admitted by the High Court.

In relation to a dispute relating to a benchmarking exercise where issues pertained to the selection of filters applied and comparables selected, the Karnataka High Court held that these do not give rise to a substantial question of law and thus appeals filed are devoid of any merit. The High Court said that mere dissatisfaction with findings of fact arrived at by the Tax Tribunal is not at all a sufficient reason to file an appeal before the High Court. The High Court rejected the contention that these appeals deserved to be adjudicated in view of different views of Tax Tribunals on the issues involved, as this does not involve any substantial question of law. The Court noted that the selection of comparables, shortlisting them, applying filters, etc. are all fact-finding exercises and therefore the final orders passed by the Tax Tribunal are binding on the lower Authorities of the tax department as well as the High Court. Unless the findings of fact are perverse, no substantial question of law arises for consideration under Section 260A.

**[Softbrands India (P.) Ltd IT Appeal Nos. 536 and 537 of 2015 (Karnataka high court)]**

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# ISRAEL

## RECENT SUPREME COURT RULINGS

### Background – The issues in question and the earlier District Court rulings

In two decisions that were handed down by the Israeli District Courts regarding 'Kontera' and 'Finisar,' (appeals 943/16 and 1728/16), an argument arose between the parties and the Israeli Tax Authority regarding the implementation of Paragraph 85A (transfer pricing) in the Israeli Income Tax Ordinance (New Version) ('Ordinance').

In both cases, the companies are an Israeli subsidiary of a US parent company, and the subsidiary served as a research and development (R&D) centre for the parent company. An agreement was signed between the parties whereby the subsidiary was contracted by the parent company to provide it with R&D services. The method used to determine the price that would apply for these services was the 'Cost Plus' method, (i.e., the cost of providing the services (the cost basis) plus a fixed rate profit from the cost basis).

Moreover, it was agreed between the entities that the parent company would grant the subsidiary's employees Employee Stock Options (ESOs) to purchase the shares of the parent company at a predetermined price. The ESOs were allotted through a deposit with a trustee for a period of at least two years, as part of the capital gains track option plan, which the Israeli entity selected, in accordance with Section 102 (b) (2) of the Ordinance.

The dispute between the Israeli companies and the Israeli Tax Authority related to the companies' request to omit the cost of ESOs from the cost base from which the profit was calculated. In contrast to the taxpayers computations (submitted by the companies), the tax assessor assumed that:

1. The cost of allocating ESOs should be included in the cost base as aforesaid.
2. In addition, he found that the cost of allocating ESOs is not tax-deductible.
3. Moreover, where the examined transaction deviated from TP analysis (effectively, the reported profit out of the total expenses resulted in a lower profit rate than the rate found in TP analysis), the assessor performed an initial and a secondary adjustment.

The District Courts upheld the tax assessor's adjustments, so the companies appealed to the Supreme Court.

### Supreme Court rulings

The Supreme Court's rulings (which support the main points of the District Court's rulings) and the conclusions that arise from them are as follows:

### 1. The cost of issuing ESOs as part of the cost base for the service transaction

According to the Supreme Court, issuing ESOs to workers is considered to be a salary expense and therefore a profit should be marked up on it. ESOs are granted to employees as part of their compensation package, with the aim of retaining their personal interest with the company's interest. Therefore, it appears that the ESOs were allocated in order to incentivise R&D employees to provide the highest possible quality services to the subsidiary and indirectly to the parent company. The better the services that are being provided, the greater the value of the parent company's share; accordingly, the value of the benefit inherent in the ESOs allocated to the subsidiary's employees will increase. Therefore, from an economical perspective, this is an incidental expense for the subsidiary that should have a mark-up.

### 2. The duty to prepare current and relevant TP analysis

The Supreme Court held that under Section 85A (c) of the Ordinance, the burden of proof in the context of Section 85A rests with the assessee who is required to establish that the price and conditions of the examined transaction are consistent with the arm's length price determined in the TP analysis. It is important to ensure that the TP analysis is established, relevant and up-to-date in the specific case, and is evidence-based.

Similarly, in accordance with the provisions of Section 85A (c) (1), the burden of proof also lies on the assessee at the initial stage. To the extent that this burden was met, i.e., he delivered all the required documents and conducted TP analysis under Section 85A, the burden of proof passes to the assessor who will be required to base his determinations regarding the transaction price in the TP analysis. In the event that the burden of proof is transferred to the tax assessor, the assessor must prove by means of 'clear and convincing' evidence that meets the level of proof of the 'balance of probabilities'.

However, where the taxpayer did not meet the burden of obtaining the initial evidence under Section 85A, i.e., failed to establish a TP analysis that characterises similar transactions appropriately – for example, if the TP analysis does not refer to transactions with similar characteristics or is not comprehensive in a manner appropriate to the circumstances of the case – the burden of proof will not be transferred to the tax assessor, and the taxpayer will not meet the burden of proof imposed on him as aforesaid.

### 3. A correct and comparative application of TP analysis to the examined transaction

The Supreme Court determined that the operating profit data of the comparable companies in the survey should take into consideration the expenses for ESOs and other benefits.

### 4. Risk assessment for initial adjustments

The median of the interquartile range is the initial adjustment target.

### 5. Risk assessment for secondary adjustments

It is necessary to examine the significance of potential secondary adjustments where a risk emerges from adjusting transfer prices (initial adjustments).

### 6. ESOs expenses were not deductible

The cost of allocating ESOs for the purchasing shares of the parent company for the employees of the subsidiary is an incidental expense under Section 17 of the Ordinance. Generally, the cost is deductible. Whereas the Israeli companies voluntarily chose to use the clause, the provisions of Section 102 (d) (2) of the Ordinance constitute a specific arrangement regarding the allocation of shares and ESOs in the capital gains track option plan that explicitly denies the deduction of this expense, which also provides a tax advantage.

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# ITALY

## NEW VERSION OF TRANSFER PRICING DECREE COMES INTO FORCE

### In brief

On 14 May 2018, the Ministerial Decree concerning transfer pricing, (the 'Decree'), currently being published in the *Official Gazette*, was issued dictating the guidelines for the implementation of the regulation envisaged by Article 110, Paragraph 7 of the Italian tax law (TUIR), recently updated by Article 59 of Decree Law 50/2017.

The fundamental structure of the Decree's original draft has been left almost unchanged, although a series of additions and two new provisions incorporating most of the suggestions received from the professional and entrepreneurial world during the public consultation phase, have been added. The main additions to the Decree relate to comparability analysis, the hierarchy of transfer pricing methods, and the verification of compliance with the arm's length principle. The two new provisions, on the other hand, can be ascribed to the 'simplified' determination of transfer prices for low value-adding intragroup services (Article 7) and the eligibility requirements of transfer pricing documentation (Article 8).

The Decree also aims to establish the already internationally-shared general principles on transfer pricing at a national level. Thus, the new provisions of Article 9 of the 2017 OECD Model Agreement and the 2017 OECD Transfer Price Guidelines, which echo those reported in Action 8-10 of the BEPS project, have been acknowledged.

### In detail

On 21 February 2018, the Ministry of Economy and Finance (MEF) issued, for a public consultation phase which ended on 21 March 2018, a Ministerial Decree implementing the new legislation on the matter of transfer prices contained in Article 110, Paragraph 7 of the TUIR, recently amended by Article 59 of Decree Law 50/2017.

On 14 May 2018, the MEF issued the final version of the Decree, incorporating most of the suggestions received from the public consultation phase and the round table held on 8 March 2018 at the MEF.

### National guidelines on transfer pricing

The national guidelines contained in the Decree are innovative and should be welcomed by operators as, in addition to reiterating the arm's length principle in full compliance with that adopted in the OECD, they provide important indications on particular domestic aspects. They also reflect the recommendations on the topic stemming from the BEPS project, already implemented by Article 9 of the 2017 OECD Model Tax Convention and the 2017 OECD Transfer Price Guidelines.

The new Italian regulation on transfer pricing addresses the notion of control, providing for the application of the relevant provisions even where there are 'associated' companies, a notion that, in the final version of the Decree, does not present substantial changes with respect to the original draft. In particular, 'associated enterprises' means 'the resident company and the non-resident companies when one of them directly or indirectly participates in the management, control or capital of the other, or if the same person participates, directly or indirectly in the management, control or capital of both companies'.

It is clear that the Decree, for the purposes of defining associated companies, intends to assign a pre-eminent role to the concept of 'participation in management, control or capital' and, in this regard, the definition given to the latter is:

- (i) Participation of more than 50% in the capital, voting rights or profits of another company; or
- (ii) The dominant influence on the management of another company, based on equity or contractual constraints.

Regarding the comparability analysis, the Decree stipulates that an uncontrolled transaction is considered comparable to a comparable transaction if:

- (i) There are no significant differences in the relevant conditions that significantly affect the financial indicator that can be used in application of the most appropriate; or
- (ii) In case of differences, appropriate adjustments can be made to increase comparability.

Paragraph 2 of Article 3 of the Decree, in line with the indications of the OECD, identifies the following economically significant elements for the purposes of comparability analysis:

- (a) The contractual conditions;
- (b) The functions performed, the risks assumed and the assets used by the parties; including the way these functions connect to the broader generation of value within the multinational group to which the parties belong, the circumstances that characterise the transaction and the customs of the sector;
- (c) The characteristics of the goods sold and services rendered;
- (d) The economic circumstances in which the transactions occur; and
- (e) The corporate strategies underlying the transactions.

It is noted that the final version of the Decree presents a significant integration related to the aforementioned letter b) and, in particular, where it is required to specify how the functions performed by the companies connect to the broader generation of value within the group. This is a clear reference to the need to conduct a functional analysis highlighting the company's role in the wider value chain of the Multinational Group to which it belongs.

In relation to the choice of the most appropriate transfer pricing analysis method, the Decree recalls the five internationally accepted OECD methods that can be applied to verify compliance with the arm's length principle in intragroup transactions. As is widely known, they are subdivided into three so-called 'Traditional' methods (comparable uncontrolled price method or 'CUP', the resale price method, and the increased cost method) and in two so-called 'Income' methods (the net margin method of the transaction or 'TNMM' and the profit-sharing method or 'Profit Split').

The choice of the most appropriate of these methods must be made considering the specific circumstances of the case, even if the very Decree specifies that, in the case of equal reliability between traditional and income methods, the application of the former is considered preferable and, in case of equal reliability between the price comparison method and the other four methods, the adoption of the CUP is preferred. In this context, the 'preference' rather than the obligation to apply traditional methods and, specifically, the price comparison method, is another important modification made to the draft of the Decree, aimed at ensuring greater domestic compliance with the OECD Transfer Price Guidelines.

As for the application of the most appropriate transfer pricing method, the Decree specifies that when the financial indicator of an intragroup transaction (or an aggregate of intragroup transactions) falls within the range of values resulting from the use of the same indicator to the uncontrolled transactions considered to be comparable, the arm's length principle is respected. Otherwise, if the financial indicator falls outside the range of values, the standard is not satisfied and, consequently, the Italian Revenue Agency can make a correction to bring the indicator within the interval. In the latter case, the final version of the Decree recognises the associated company's right to present elements that certify compliance with the arm's length principle of the controlled transaction, obliging the Italian Revenue Agency to provide suitable justification for not taking into account these elements in the transfer pricing examination and adjustment.

Finally, even in its final version, the Decree does not specify which range of values should be used to verify compliance with the arm's length principle (interquartile range or extended range of values or 'full range'). In this regard, the wording of Paragraph 1 of Article 6 of the provision does not seem to categorically exclude the aggressive approach recently adopted by the verifiers of bringing the arm's length value to central tendency statistical indicators (usually the median). It is hoped that this operational issue will be the subject of future clarifications by the Italian Revenue Agency.

### What's new in the decree post-consultation

Among the most noteworthy innovations found in the post-consultation Decree are the two new articles introduced in the final version – and not present in the original draft – concerning the 'simplified' determination of transfer prices for low-level added value services (Article 7) and the suitability of transfer pricing documentation (Article 8). Article 7 introduces a provision on low added value services that is compliant with the content of Chapter VII of the OECD Guidelines, as recently integrated by Action 10 of the BEPS project.

This provision provides for a 'simplified' approach for the determination of transfer prices in relation to intercompany transactions consisting in the provision of low added value services, or what can be considered services that are not an integral part of the Multinational Group's core business.

The simplified approach involves the determination of the price based on direct and indirect costs incurred for the performance, as well as a mark-up of 5%. The introduction of this provision was welcomed by the operators, as it now also corroborates, at the domestic level, an approach to more easily justify the 'management fees' paid to subjects providing routine services belonging to the same Multinational Group. However, it will still be necessary to evaluate, on a case-by-case basis, which services can be considered 'low added value' and which, on the other hand, determine a competitive advantage for the Multinational Group.

Then, Article 8 of the Decree intervenes on the necessary requirements of the transfer pricing documentation prepared by the taxpayer defining what is considered 'suitable', thus aiming to guarantee the benefit of exemption from administrative sanctions ('penalty protection').

The innovative nature of the provision is noted where the Decree establishes that the presence of omissions or inaccuracies – not likely to jeopardise the controlling activity of the Financial Administration – cannot undermine the suitability of transfer pricing documentation. Suitability cannot be compromised even if the taxpayer has adopted a transfer pricing method or selected transactions or subjects comparable in a manner different from that identified by the Italian Revenue Agency.

Therefore, only documentation which does not provide the data necessary for transfer pricing analysis will be considered unsuitable, with consequent non-use of the penalty protection regime.

In conclusion, the Decree embraces a 'substantial' approach in the verification of transfer pricing documentation suitability requirements, in line with recent jurisprudence guidelines (see CTR Lombardy 1 June 2017, No. 2454). In any case, the Decree refers to the provision of a future legislative update by the Director of the Italian Revenue Agency concerning the documentary charges for the usability of the penalty protection regime and, likewise, the practical implementation of Article 8.

### Conclusions

The issue of national guidelines on transfer pricing has put Italy among the countries with advanced transfer pricing legislation and in line with recent updates made internationally by the BEPS project. However, it appears appropriate that the Italian Revenue Agency should clarify some aspects of the new regulations that are still controversial, thus ensuring greater certainty in the operating context.

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# THE NETHERLANDS

## NEW DUTCH TRANSFER PRICING DECREE

On 11 May 2018, The Netherlands published the new Dutch transfer pricing decree ('TP decree'). The TP decree describes the State Secretary for Finance's interpretation of the arm's-length principle and replaces and updates the earlier TP decree of 14 November 2013, taking into account recent developments, especially 'BEPS' and the revised July 2017 OECD TP Guidelines. The TP decree generally reflects the Dutch Tax Administration (DTA)'s views. It provides a further interpretation of the arm's-length principle where the OECD Guidelines leave room for interpretation or where there is ambiguity.

In this article, we describe the main points of the new Dutch TP decree.

### Main points

#### (Re-)characterisation of a transaction

The TP decree generally adopts the 'control over risk framework' of the 2017 OECD TP Guidelines as part of a detailed functional analysis for the characterisation of an intercompany transaction. The starting point of the characterisation should be the contractual arrangements, but the TP decree provides additional guidance on re-characterisation. In certain situations, the consequences may be that a transaction should be disregarded for tax purposes.

#### Profit Split

If economically significant risks are contractually assigned to one party that in fact contributes only minimally to the control of such risks, the TP decree explicitly states that the Transactional Profit Split method could be an appropriate method to apply.

#### Cost-based remuneration

The TP decree provides specific guidance regarding the cost basis and treatment of disbursements under a cost-based method. Only the costs that directly or indirectly relate to the transaction and the costs that are a relevant value indicator of the functions, assets and risks are to be part of the cost basis. Examples are provided of disbursement types of cost and the situation of raw materials costs excluded from a toll manufacturer's cost basis.

Furthermore, the TP decree specifies that in the case of the sale of goods through a Dutch intermediary, where this intermediary does not perform any relevant sales activities, but merely provides administrative services supporting the sales function, such activities should in principle be remunerated based on the intermediary's costs instead of its revenue. In this case, the Dutch intermediary usually registers the revenue in its Profit and Loss account.

#### Multiple year data

Based on the 2017 OECD TP Guidelines, the use of multiple year data does not necessarily imply the use of multiple year averages, which can however be used in some circumstances to improve reliability. The TP decree specifies that if a tested transaction does not lie within an arm's length range based on single year data, but lies within a range based on multiple year averages, the remuneration is considered to be at arm's-length.

#### Intangibles

The TP decree provides an additional interpretation on the 'DEMPE' analysis as included in the 2017 OECD TP Guidelines, and adds that generally a higher weighting will be given to the 'Development' and 'Enhancement' functions in determining the relative contribution to the value of the intangible.

#### Hard-to-value-intangibles

Regarding the guidance provided by the 2017 OECD TP Guidelines on Hard-to-value intangibles (HTVI), the State Secretary considers that a significant deviation (see Section 6.193 of the 2017 OECD TP Guidelines) is a deviation of more than 20% between the projections and the actual result. An intangible will not be considered a HTVI if the significant deviations start to occur after a period of five years starting from the moment third party revenue in relation to the intangible was realised.

#### Business restructuring

The TP decree describes business restructurings specifically in the context of the post-acquisition restructuring of a recently acquired entity/business. In these situations, 'acquisition files' provide an essential part of the transfer pricing documentation for a business restructuring and therefore should be submitted to the DTA upon request.

If the business restructuring involves de-risking of an entity to the extent that only routine functions remain in the restructured entity, the DTA may state that a valuation of the routine functions should not be performed on the basis of routine cash flows that can be expected in perpetuity, but a shorter period.

#### Critical approach to royalty databases

Remuneration for the use of intangibles may be determined based on a royalty database. The DTA often takes the position that intangible assets are by nature unique and can therefore not be measured by way of a royalty database. Therefore, the use of these databases in benchmark studies will be critically assessed by the DTA. Instead, a residual profit approach could be a better transfer pricing method, assuming all other important functions, risks and assets are appropriately remunerated.

#### Low value adding services

The State Secretary adopts the simplified method to determine the arm's length nature of low-value adding intra-group services, as described in the 2017 OECD TP Guidelines. Taxpayers may opt to recharge costs incurred with these low value adding services, increased by a mark-up of 5% and using an appropriate cost allocation key. Furthermore, the TP decree mentions that in case this practical approach is chosen, the finance costs also have to be taken into account.

#### Implications

Dutch taxpayers are not bound by the TP decree, but can expect to be challenged by the DTA if they do not act in accordance with it. The changes in the TP decree may also apply to the years prior to its publication. The State Secretary for Finance states that this TP decree is a further clarification of the arm's-length principle. As this principle was also applicable in earlier years, the TP decree applies retroactively to a TP position in a year prior to its publication. Dutch taxpayers should consider the changes and review whether their transfer pricing documentation and practices are consistent with the new TP decree.

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# PERU

## AMENDMENTS TO THE PERUVIAN TRANSFER PRICING RULES

At the end of 2016, the Peruvian Government, as one of its tax measures, proposed to adapt the national legislation to international standards and recommendations issued by the Organisation for Economic Cooperation and Development (OECD).

In this context, from the end of 2016, mid-2017 and beginning of 2018, amendments focusing on the transfer pricing rules were made in the Income Tax Law (LIR), specifically Article 32-A of LIR. These amendments have been formulated taking as a reference the approaches indicated in the Base Erosion and Profit Shifting (BEPS) Plan.

Among the most relevant changes, to be described later, is the adoption of the three-tiered approach to transfer pricing documentation proposed in the BEPS Plan; that is, that local taxpayers under the scope of transfer pricing, if they meet certain requirements, must submit to the Peruvian Tax Administration the Local File, Master File and Country-by-Country Report. Other significant changes relate to intra-group services, starting with 2017 TP formal obligations, regarding the application of the benefit test and the definition and application of a specific mark-up of the so-called 'low value-adding services'.

In general, from our experience in relation to the 2016 TP obligations, the description of the internal and external organisational structure of the local taxpayer and the functional analysis of each of the transactions carried out by Peruvian taxpayers with related parties or tax havens have become more relevant in Peruvian transfer pricing documentation.

### Concepts modified and/or incorporated into the LIR in relation to TP

#### 1. Formal Obligations – TP Documentation

#### 2. TP Methods

- CUP method, application for the cross-border commodities and derivative financial instruments transaction;
- Other methods.

#### 3. Intragroup services

- Benefit Test;
- Low value added services.





## 1. Formal Obligations – TP Documentation

TP Documentation	FY 2016	FY 2017 and so
<b>Informative Tax Return Local File</b>	Peruvian taxpayers whose annual revenue for the FY 2017 is equal or exceeds 2,300 UIT or PEN 9.085 million (approx. USD 2.8 million)	Peruvian taxpayers whose annual revenue for the FY 2017 is equal or exceeds 2,300 UIT or PEN 9.315 million (approx. USD 2.8 million)
<b>Informative Tax Return Master File</b>	Not required	Taxpayers that are a member of a Group whose individual annual revenue for the fiscal year exceeds 20,000 Tax Units (approximately USD 23.82 million or PEN 81,000,000)
<b>Informative Tax Return Country-by-Country</b>	Not required	Taxpayers that are a member of a multinational Group, whose annual revenue earned as a Group (sum of each one of the Group members or entities) in the fiscal year is greater than or equal to PEN 2,700,000,000 (EUR 750 million)

## 2. Transfer Pricing Methods

### – Comparable Uncontrolled Price Method – application for so-called commodities

It has been indicated that the CUP method will be the most appropriate for the analysis of export or import operations of goods with a known price in the international market (commodities), local or destination, including derivative financial instruments whose prices are fixed by reference to quotes of those markets.

The market value will be determined on the basis of the date or period of the quotation value that the taxpayer communicates to the Peruvian Tax Administration, as long as those quotations are in accordance with the agreement between independent entities in similar conditions. If the Peruvian taxpayer does not inform the Peruvian Tax Administration of this, the date of embarkation or disembarkation will apply for market value purposes.

### Pending regulation

The following matters are pending regulation:

- Goods included;
- The international market or referential quotation;
- Quotation to be considered; and
- Acceptable adjustments to reflect characteristics of the goods and type of transaction.

### – Other methods

The possibility of applying other methods to determine market value has been incorporated, when due to the nature and characteristics of the activities and transactions the application of any of the six methods previously established by the LIR is not appropriate – for example, valuing intangible assets.

The Regulation should indicate or state what these 'Other methods' are and for what type of operations may be applied.

## 3. Intragroup services

### – Benefit test

In the case of services provided by related parties, the local taxpayer must comply with the benefit test and provide documentation and information requested as necessary conditions for the deduction of the cost or expense.

- When is it understood that the benefit test is satisfied?

When the rendered service provides economic or commercial value to the service recipient, improving or maintaining its commercial position, which occurs if independent parties have satisfied the need for the service, executing it by themselves or through a third party.

- What should evidence the information provided?

The documentation and information provided must demonstrate the effective provision of the service, the nature of the service, the actual need for the service, and the costs and expenses incurred by the service provider, as well as the reasonable allocation criteria of those.

The deduction of the cost or expense for the service received is determined based on the sum of the costs and expenses incurred by the service provider, as well as their profit margin.

### – Low value added services

In the case of low value-adding services, the profit mark-up may not exceed 5% of the costs and expenses incurred by the service provider.

Which services are considered as low value added services?

Those which:

- (i) Are or have a supportive nature.
- (ii) Do not constitute major activities of the taxpayer or of the group.
- (iii) Do not require the use of, and lead to the creation of, unique and valuable intangibles.
- (iv) Do not entail assuming or controlling a high or significant level of risk or generating a significant level of risk to the service provider.

It is necessary to define with clarity, objectivity and functional and economic criteria which services will be considered as low added value. It will not be a simple task.

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# UNITED KINGDOM

## COUNTRY-BY-COUNTRY REPORTING UPDATE

### Current position

**M**any groups have now submitted (or are about to submit) their first Country-by-Country Report (CbCR) to the relevant tax authorities. What happens next, and what can taxpayers expect to see in the coming months?

Firstly, the CbCR will be shared between the relevant tax authorities, the timelines for the sharing of information broadly being:

- 18 months post year end for the first period (i.e. by 30 June 2018 for 31 December 2016 period ends); and
- 15 months post year end thereafter (i.e. by 31 March 2019 for 31 December 2017 period ends).

Once the CbCR has been shared, tax authorities will face the challenge around how to make effective and appropriate use of the information that the CbCRs contain. There is a risk that the wealth of additional information will give rise to misleading or simplistic conclusions, and the OECD has anticipated this challenge. Guidance has been issued, set out below, and will be of interest to company groups as well as tax authorities.

### OECD Effective Tax Risk Assessment handbook

In September 2017 the OECD published a CbCR-specific **handbook** on 'Effective Tax Risk Assessment', which broadly focuses on:

- A commentary on the different approaches to assessing tax risk across the globe;
- How CbCR can be used to detect tax risk across the various approaches;
- The relevant tax risk indicators specific to CbCR; and
- The challenge that tax authorities face in identifying tax risks.

The handbook makes it very clear that the information contained within the CbCR should be used in conjunction with other information sources in allowing a tax authority to assess the level of tax risk.

Caution is raised around the risk of misleading or simplistic conclusions being drawn by analysing the CbCR in isolation.

In looking at the different approaches to tax assessment that tax authorities currently use, the handbook includes detailed examples for various territories including Australia, India, Brazil and Spain. These examples focus on:

- Timing of tax risk assessments (real time vs post tax return filing);
- The use of automation and technology in assisting with tax risk assessment; and
- A centralised vs decentralised approach to assessing tax risk.

Given the resource constraints that many authorities face, the handbook has been published in order to assist authorities in incorporating the CbCR into their current risk assessment framework.

The handbook includes comments on general transfer pricing risk areas along with 19 specific tax risk indicators in respect of CbCR (and highlights some key ratios).

### Specific indicators

The indicators are contained in a table in Annex 2 of the handbook. For each of the 19 tax risk indicators, the table outlines 'What this could mean' and 'How else it might be explained'.

For example, for the risk indicator 'IP is separated from related activities within a group', the table outlines that this could mean that 'Valuable IP may be used to strip taxable profit from other jurisdictions', and goes on to give the possible explanation that 'IP may be held in a particular jurisdiction for non-BEPS purposes. So long as the royalties paid for use of IP are arm's length and there are no other indicators of BEPS, the tax risk to a jurisdiction may be low.'

The table will help groups to see which of their activities might be perceived as a tax risk by the authorities, and take remedial action where possible.

### Specific ratios

The handbook also includes a list of specific ratios that should be used by tax authorities in assessing the financial information held in the CbCR. These ratios could be compared to the prior year and also across sectors and industries, and include:

- Proportion of related party vs non-related party revenue;
- Revenue per employee;
- Pre-tax profit per employee;
- Revenue per GBP/USD/EUR of tangible asset;
- Pre-tax profit per GBP/USD/EUR of tangible asset;
- Pre-tax return on equity;
- Post-tax return on equity;
- Profit margin; and
- Effective tax rate.

We would also expect that the allocation of financial data as per Table 1 of the CbCR is tracked year on year along with any significant increases/decreases, again year on year.

### Use of CbCRs by tax authorities

The OECD makes it clear that the CbCR should not be used in isolation, and that tax authorities should use the CbCR in conjunction with other information in order to conclude their risk assessment. Other sources of information may include:

- Information held by the tax authority:
  - Tax returns;
  - Other domestic tax reporting requirements;
  - TP documentation;
- Information available from other government sources:
  - Customer information;
  - Information held by registers of companies;
- Publicly available information:
  - Financial reports and annual accounts;
  - Websites, press reports;
  - Stock exchange and other filings;
- Commercially available information:
  - Ratings agencies information;
  - Commercial databases.

### Impact on taxpayers

Prior to the introduction of CbCRs, recent trends have been for transfer pricing tax audits to increase around the globe. The CbCR will enable authorities to focus their resources on groups that have the greatest risk.

The expectation is that the focus on transfer pricing will continue (both by tax authorities and also by all stakeholders of a business).

Given that the CbCR is one of three tiers of documentation specified in BEPS Action 13, we are expecting requests from tax authorities to view transfer pricing documentation to increase significantly going forward (both for 'large' and all taxpayers).

### What are taxpayers doing?

For many groups, the financial information contained in their CbCR has focused their attention on:

- Analysing whether the results are in line with expectations;
- Analysing the group's results vs the specific tax risk indicators;
- Reviewing operating models in light of the updated OECD Transfer Pricing guidelines;
- Ensuring that documentation is prepared in line with the new OECD requirements, and that this is kept up to date; and
- Improving internal governance around transfer pricing.

The focus on the above has been seen across the board and not just for those taxpayers caught by CbCR; reasons for driving the focus on TP have included:

- Brexit and the potential change in supply chains;
- US Tax Reform causing groups to consider their overall transaction models;
- In the UK, the requirement for companies to publish their Tax Strategy, and the Senior Accounting Officer rules; and
- Increasingly onerous transfer pricing disclosure and documentation requirements passing into domestic law across multiple territories.

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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 30 August 2018.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Peruvian Nuevo Sol (PEN)	0.25879	0.30250
US dollar (USD)	0.85549	1.00000
British Pound (GBP)	1.10613	1.29296
Euro (EUR)	1.00000	1.16878

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