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INTRODUCTION

Transfer pricing triggers more and more attention of tax authorities, tax legislators and the OECD. This 8th issue of BDO's Transfer Pricing Newsletter focuses on recent developments in the field of transfer pricing in Hungary, Mexico, Spain and the United States. Our article about transfer pricing in Brazil is of a more general nature, outlining the transfer pricing rules and listing the differences in the Brazilian approach towards transfer pricing, compared to the standard OECD Transfer Pricing Guidelines driven models.

In this newsletter you will also find an interesting contribution about the recent OECD report on aggressive tax planning where OECD categorises non-arm's length practices as one of the most important risk areas of aggressive tax planning.
As there is a constant and increasing demand for transfer pricing engagements to be run properly, BDO's Transfer Pricing Centre of Excellence is very pleased that the transfer pricing teams in many countries keep growing. An experienced team of transfer pricing advisors is key to a further development of BDO's global transfer pricing capabilities.

BRAZIL
TRANSFER PRICING IN BRAZIL

The transfer pricing rules adopted by Brazil in 1996 deviate to a certain extent from the OECD Transfer Pricing Guidelines. Despite basically following the methodology suggested by the OECD Guidelines, Brazilian law adopted fixed margins for the various methods, regardless of the specific situation of the taxpayer or peculiarities of the business. The criteria for searching for and adopting comparables are not clearly regulated. The transfer pricing rules expressly authorize only two comparability factors: specific contractual terms and some differences in characteristics of similar products, services or rights. In addition, there is not much leeway for advance pricing agreement (APA) procedures. The related-party test covers several relationships and is not restricted to associated enterprises.

Transfer pricing rules for import transactions

Under Brazilian transfer pricing rules, until the 2009 calendar year, there were three methods for determining the price limit for products, services or rights imported by Brazilian companies from associated enterprises:

- the comparable uncontrolled price (CUP) method for import transactions. The transfer price is based on the average price of identical or similar products or services applied in purchase and sale transactions carried out in either the internal or external market under similar payment conditions;
- the resale price less margin method. The transfer price is based on the average resale price of the goods applied by the importer in transactions with independent parties, less unconditional discounts, taxes, brokerage fees and profit margin of (1) 60% of the resale price of the final product, less the deductions mentioned above and less costs aggregated in Brazil by the importer, in the case of imported goods used in the production process or (2) 20% of the resale price of the imported goods, in general; and
- the cost-plus method. The transfer price is based on the average production cost of identical or similar products, services or rights in the jurisdiction in which such products, services or rights were originally produced, increased by taxes paid in that jurisdiction and with a fixed profit margin of 20% of the cost net of taxes.

If more than one method could apply, the company may choose the method resulting in the highest import price in order to prove its compliance with Brazilian transfer pricing rules.

If the average price paid by the Brazilian importer exceeds the average price determined under these methods, a transfer pricing adjustment is required and, as a consequence, the excess amount will be added to the importer's taxable base. Conversely, if the average price paid by the Brazilian

importer is less than the price determined under Brazilian transfer pricing rules, no tax adjustment is required.

Finally, intercompany loans registered with the Central Bank of Brazil are not subject to the transfer pricing rules. In the case of intercompany loans not registered with the Central Bank of Brazil, interest expenses payable by Brazilian companies to non-resident associated entities or entities located in lowtax jurisdictions are deductible for corporate income taxes purposes up to the amount determined by the Libor rate, increased with a 3% annual spread.

Note that Provisional Measure 478, issued on 29 December 2009, proposed a replacement of the resale price less margin method for the sale price less margin method. Basically, under this new method, the transfer price would be based on the average resale price of the goods applied by the importer in transactions with independent parties, less unconditional discounts, taxes, brokerage fees and profit margin of 35% of the resale price of the final product, less the deductions mentioned above and less costs aggregated in Brazil by the importer. In the event, Provisional Measure 478 did not become law, and this change was not implemented.

Transfer pricing rules for export transactions

Whenever the average sale price of goods, services or rights exported by a Brazilian company in a taxable year is less than 90% of the average price applied in sales of the same goods, services or rights by that company in the domestic market in the same taxable year and under similar payment conditions, the price of those goods, services or rights will be determined by tax authorities under one of the four methods established by Brazilian law. The applicable methods are:

- the CUP method for export transactions (PVEx). The transfer price is based on the average price of identical or similar services, products or rights charged by a Brazilian company with foreign independent parties, in the same taxable year and under similar payment conditions;
- the wholesale price in the country of destination, less profit margin method (PVA). The transfer price is based on the average sales price of identical or similar products, applied in the wholesale market of the country of destination of the exported products, under similar payment conditions, less local taxes and less a 15% fixed profit margin for the wholesale transaction;
- the retail price in the country of destination less profit margin method (PVV). The transfer price is based on the average sales price of identical or similar products, applied in the retail market of the country of destination of the exported products, less taxes and less a 30% fixed profit margin; and
- the acquisition or production cost, plus taxes and profit margin method (CAP). The transfer price is based on the average acquisition or production costs of the exported products, services or rights, increased by Brazilian taxes and with a 15% fixed profit margin, calculated on costs and taxes.

Brazilian law adopts some safe harbour rules for transfer pricing of export transactions. Under the first general safe harbour rule, a taxpayer is deemed to have applied an appropriate transfer price when the average export sales price is at least 90% of the average domestic sales price in the Brazilian market during the same period and under similar payment terms. A second safe harbor rule allows a difference of up to 5% (upwards or downwards) between the adjusted-limit price and the transaction price.

Two other safe harbours aim at simplifying the application of the transfer pricing rules (these two other safe harbours are not considered true safe harbours, because tax authorities are still required to observe the transfer pricing methods). The first provides that if the exporter is able to prove that the net commercial profit derived from the export transaction is equal to at least 5% of the export income, based on annual averages, the exporter may prove the appropriateness of its transfer pricing based exclusively on the export transaction documents. The other safe harbour rule provides that if the exporter is able to prove that the net export income does not exceed 5% of the total net income in the same calendar year, the exporter may prove the appropriateness of its transfer pricing based exclusively on the export transaction documents.

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OECD

OECD REPORT: AGGRESSIVE TAX PLANNING AND TRANSFER PRICING

Tggressive tax planning is a source of increasing concern for many countries. Countries have developed various strategies and increased international co-operation to deal with that problem. Within aggressive tax planning, practices circumventing the legal restrictions on offsetting losses are especially of concern when the world is facing a financial and economic crisis, and the amount of global corporate losses is becoming enormous.

Apart from the immediate impact on tax revenues of huge losses as a result of the standard loss relief rules, these losses also raise tax compliance risks, particularly if companies turn to aggressive tax planning as a means of increasing and/or accelerating tax relief on their losses.

The OECD report Corporate Loss Utilisation through Aggressive Tax Planning was prepared jointly by the Forum on Tax Administration (FTA) and the Aggressive Tax Planning (ATP) Steering Group of Working Party No. 10 on Exchange of Information and Tax Compliance of the Committee on Fiscal Affairs (CFA), under Germany's supervision. The report is partly a continuation of the thoughts started in the earlier OECD report Addressing Tax Risks Involving Bank Losses (2010) and the OECD publication
Report on the Attribution of Profits to Permanent Establishments (2008).

In brief, the report describes the size of corporate tax losses and the policy issues related to their tax treatment. In addition, the report identifies three key risk areas in relation to the use of losses for tax purposes: corporate reorganisations, financial instruments and non-arm's length transfer pricing. Further, the report summarises aggressive tax planning schemes encountered by revenue bodies, together with their detection and response strategies.

The report describes a number of aggressive tax planning schemes such as loss-shifting schemes, schemes shifting profits to a loss making party, schemes circumventing time restrictions on the carry-forward of losses, schemes circumventing change of ownership/activity restrictions on the carry-forward of losses, schemes circumventing rules on the recognition or treatment of losses, schemes creating artificial losses, and schemes involving the dual/multiple use of the same loss. The report concludes that such schemes are most likely to occur in the areas of implementing financial instruments, corporate reorganisations and also, as the report clearly states, transfer pricing.

In the report, reference is made to those non arm's length transfer pricing practices that are a result of tax-driven changes to the structure of multinational enterprises (MNEs) and the related transfer pricing policies. Such changes result in, for instance, shifting functions and risks and allocating losses to relatively high-tax jurisdictions. Transfer pricing concerns have also been identified in relation to financial transactions, for example non-arm's length prices for guarantee fees and related party interest rates, and after-tax hedges.

The OECD is aware of the fact that under normal business conditions, the entrepreneur's central entities located in high-tax jurisdiction may suffer losses, while the low-risk affiliates may remain profitable. In such a situation, some companies may be tempted to change established transfer pricing policies, and shift the functions and risks by, for instance, amending existing intercompany agreements in order to reallocate losses throughout their supply chain.

The report reiterates that according to the arm's length principle, the remuneration of a subsidiary or profit allocation to a branch that is part of a multinational group has to reflect the functions performed, taking into account the risks assumed, the assets used by it and the complete supply chain of the MNEs. In that sense, the report confirms the position taken in the earlier OECD publication, the Report on the Attribution of Profits to Permanent Establishments (2008), where emphasis was made to the more sophisticated allocation of assets and profits by MNE's and the necessity of an analysis of the MNE's entire value chain.

The report also makes interesting remarks about the domestic tax legislation problems that may trigger a tax-driven change of established transfer pricing policies. The lack of specific anti-avoidance rules as well as the misinterpretation of tax provisions are, according to the report, the major problems that could lead to misuse of transfer pricing in domestic tax regimes.

Nevertheless, the report does not make any specific recommendations to policymakers on how to address the problems of non arm's length transfer pricing with regard to reallocating losses.

In summary, the recent OECD report continues to emphasise the importance of an analysis of the entire value chain in order to limit aggressive non-arm's length tax planning schemes. It is a bridge too far to assume that placing more importance on the entire value chain is becoming a transfer pricing trend. However, in its recent changes to the transfer pricing legislation, Germany follows the OECD viewpoint on this matter. Finally, the clear categorisation of transfer pricing practices as aggressive tax planning by the OECD is likely to attract more public attention towards transfer pricing in general.

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HUNGARY

SIMPLIFYING TRANSFER PRICING DOCUMENTATION IN HUNGARY

Based on a decree of the Minister for National Economy published in December 2011, the rules for preparing transfer pricing documentation changed with effect from 1 January 2012. The simplifications can be taken into account when preparing documentation for the 2011 tax year if the deadline for preparing the documentation is after 1 January 2012.

Changes regarding the range of taxpayers obliged to prepare transfer pricing documentation

The range of enterprises not subject to the documentation requirement has been expanded. No transfer pricing documentation now needs to be prepared in the following cases:
- Transactions between the foreign permanent establishment of a resident taxpayer and the related parties of the resident taxpayer if no corporate tax base adjustment is otherwise needed because the resident taxpayer applies exemption to the determination of the tax base on the basis of an international contract. This provision does not apply to transactions between a foreign enterprise and its resident permanent establishment or between a taxpayer and its foreign permanent establishment.
- Cases in respect of which the Tax Authority determined the price within the framework of an Advanced Price Agreement (APA). The exemption applies throughout the duration of the decree.

- Cost transfers specified in the decree. These are cost transfers in the same form, not linked to the enterprise's main activity, and the party actually providing the service or selling the product is not a related party of either of the parties.
- The provision of non-repayable funds.
- Where the aggregate net value of a contract, applying the arm's length price, is below HUF 50 million for the period between the commencement of the contract and the last day of the tax year. When calculating the value limit, the aggregate value of contracts that can be consolidated must be taken into account.

Low value added intra-group services

As no transfer pricing documentation needs to be prepared in respect of transactions valued at less than HUF 50 million, based on the above section, the term "simplified documentation" – relating to earlier simplification rules for transactions valued at less HUF 50 million – has been abolished.

'Low value added intra-group services' has been introduced as a new term. This covers routine services that are provided by a group member outside its main activity to another member or members of the group, in such a way that the services are not directly related to the users' main business activity and represent no business value for them, and the value of neither the provided nor the used service exceeds the following value limits:
- HUF 150 million in the tax year, based on the aggregate net value of contract-based performance, applying the arm's length price;
- 5% of the net sales revenue, in the case of a service provider;
- 10% of the net sales revenue, in the case of a service user.

Compliance with the conditions must be examined in respect of the taxpayer that prepared the documentation, taking into account the aggregate value of transactions that can be consolidated.

The types of low value added intra-group services mentioned in the decree include IT services; real estate management; legal, accounting, auditing, tax advising, translation, interpretation, and certain market research activities; certain educational, administrative, and transportation services, as well as other accommodation, canteen services, and guarding and security services. Simplified documentation may be prepared with respect to low value added services, by applying the cost plus method. In the documentation the arm's length price may be determined on the basis of information available without a comparative analysis if the margin falls between 3% and 7%. If the margin is outside the 3%-7% range, the arm's length price must be presented using comparative data.

The preparation of simplified documentation is not permitted if in the current tax year or the two preceding tax years low value-added services were provided to or received from not only a related party, but also to/from independent parties, and an arm's length margin for these independent comparable transactions is outside the 3%-7% range.

Other changes

The maximum default penalty that can be imposed due to a failure to prepare transfer pricing documentation will be higher. If taxpayers fail to fulfil their documentation obligations (including the safe-keeping of documents) related to the determination of arm's length prices, the maximum penalty remains at HUF 2 million per record (consolidated record) on the first occasion. If, however, taxpayers are in breach of the requirements after the first tax inspection, the maximum penalty on the second occasion will rise to HUF 4 million per record. Penalties can be even higher if taxpayers are found to be in a repeated breaches of the requirements in connection with records that have already been or would have been inspected. In these cases, a default penalty eight times the one imposed on the first occasion can be levied. Tax inspectors have discretion to reduce penalties to an unlimited extent if taxpayers prepare the required documents after an inspection.

With effect from 1 January 2012, taxpayers must report data not only on those related companies that are still in operation (within 15 days from the commencement of the first contract), but also the end of a relationship (within 15 days from the termination).

Under the amendments, with effect from 2012, in the case of transactions between Hungarian taxpayers and their branches and related parties abroad, pre-tax profits will not be adjusted with the arm's length price if, based on international treaties, the taxpayer calculates its corporate tax base in a manner that does not include income taxable abroad.

With effect from 2012, during a tax inspection, the Tax Authority will also accept transfer pricing documentation in English, German or French. However, the strict Hungarian statutory regulations will continue to apply to the content of transfer pricing documents. Accordingly, the use of transfer pricing documents prepared by foreign companies in the above languages may carry significant risks for domestic companies.

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MEXICO
FAVOURABLE TRANS FERPRICING RULING

In May 2011 a ruling was issued by the Federal Tax Court (TFJFA), which is important for transfer pricing purposes, because it creates a precedent in this area, especially in relation to the relevant application of the appropriate methods, the use of adequate comparability adjustments and above all, what is allowed under Mexican legislation.

Background
The taxpayer had transfer pricing documentation from the year 2004 which indicated that its transactions with related parties resident abroad were carried out as if they involved independent third parties; however, a review by the Mexican tax authorities identified certain issues, which are described below:
- In their opinion, the application of the Resale Price Method contained certain deficiencies.
- They questioned some of the comparability adjustments made.
- They identified relative differences in the levels of accounts receivable and inventories.
- There was a lack of consistency in the comparables used, because companies which had previously been used were eliminated.

- They strongly contested the use of information from certain years, because according to the authorities only information and prices from the year 2004 should have been considered.

The tax authorities therefore concluded that in the inventory purchase transactions, the taxpayer paid a higher price than that which would have been used by or between independent parties, and raised an assessment for underpaid tax.

Dispute

The taxpayer appealed against the ruling, bearing in mind the following:

- It accepted the application of the method used by the tax authorities and incorporated the comparables which the tax authorities used in their analysis.
- It argued that the business cycle of its industry was three years, taking into account the production and billing cycles.
- It considered the specific levels of the operating expenses of the taxpayer compared to those of the comparables and carried out comparability adjustments.

Ruling

The Second Metropolitan Regional Court analysed the evidence presented by the taxpayer and the tax authorities, and included the opinions of experts called by both parties, and those of an independent third party expert, on which basis it issued the following conclusions:

- None of the experts was able to provide sufficient evidence to demonstrate that the adjustment for the level of operating expenses could not be appropriate, so the Court considered that the adjustments were appropriate in accordance with the relevant terms of the law.
- The ruling took into account that article 215 of the Income Tax law states that certain adjustments may be made to eliminate differences which could affect results.
- Furthermore, Mexican laws contemplate the use of the Transfer Pricing Guidelines issued by the Organization for Economic Cooperation and Development (OECD). In accordance with such guidance, when the resale price method is applied, the gross margin obtained is a representation of the amount which the reseller could use to cover his operating expenses, based on the assets, functions and risks that it assumes.
- According to the argument of one expert, based on the economic logic of any business, a distributor establishes his price based on the production costs and operating expenses necessary to obtain a certain level of profit.
- Bearing in mind the adjustments for the level of the operating expenses, it might be concluded that the taxpayer was in compliance with the arm's-length principle.
- For the purposes of the Court, to ensure the adequate application of the resale price method it is essential to consider the comparability adjustments (accounts payable, inventories and level of operating expenses).
- It considered that the use of several fiscal years would have been considered not only to reflect the consistent comparability of the results, but also because they are useful to normalize results, especially in a period where there are price variations.

Pursuant to the foregoing, the Court concluded that the purchases of products for distribution made by the taxpayer from a third party complied with the arm's-length principle; i.e., they were made under the same terms and conditions that would have been applied by independent parties in similar economic circumstances.

Accordingly, the ruling which resulted in an unpaid tax liability was improperly made, and violated the principle of legality established in Mexican laws1.

Conclusions

Some points which the ruling confirms are as follows:

- Given the complexity of this issue, the arguments presented based on the merits of the case were effectively considered by the tax court.
- The viewpoint of the tax authorities in the review was very important; however, it was not definitive.
- The ruling in favour of the taxpayer, overturning a supposedly unpaid tax liability, creates a legal precedent which could be used to resolve other cases of a similar nature.
- Nevertheless, there is the possibility of an appeal by the tax authorities, but this case sets an important precedent, because the ruling took into account the work of experts to carry out a specialized transfer pricing analysis.

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SPAIN

RECENT TRANSFER PRICING DEVELOPMENTS AND EXTENSIVE AUDIT OF TRANS

The new Spanish government of the center-right Popular Party of prime minister Rajoy has recently introduced a series of measures to reduce the state deficit of Spain. On top of the package of tax increases and spending cuts, specific actions have been announced to enhance the tax inspection process and further combat tax fraud, with an explicit focus on international transactions, i.e. related party transactions in general and (un) related party transactions with tax havens in particular.

International transactions carried out between a Spanish taxpayer and countries that were previously on the official tax haven black list, such as Andorra, Panama, the Bahamas and the Netherlands Antilles will receive particular attention, due to the coming into force of the respective information exchange agreements.

Focus on transfer pricing

Transfer pricing has been on the priority list of the Spanish Tax Administration (STA) for many years. Until 2007, however, the STA did not have sufficient technical tools, information and resources to adequately assess the arm's length nature of related party transactions, basically due to the absence of any formal transfer pricing documentation requirements. This changed at the end of 2006, when the former socialist government of prime minister Zapatero laid the basis for far-reaching transfer pricing documentation requirements in the 'Act on Measures for the Prevention of Tax Fraud' (36/2006).

Documentation requirements and penalties

The 2006 legislation (and additional measures that were taken in later years), dramatically changed the transfer pricing landscape in Spain. Taxpayers are now obliged to selfassess the transfer prices that were applied in transactions with related parties, and to adjust the prices if the arm's length principle, as defined by the OECD Guidelines, has not been met. More importantly, the taxpayer (with certain exceptions) must prepare an annual set of transfer pricing documentation, consisting of a group masterfile, with general background information, and taxpayer-specific documentation, containing the functional and economic analysis of the related party transactions. These documentation obligations are enforced by a rigid penalty regime, linked both to the (non-)compliance with the arm's length principle and the availability of the information items that must be included in the documentation by virtue of the Spanish Corporate Income Tax Regulations.

The series of transfer pricing measures have undoubtedly changed the mindset of Spanish tax inspectors, who traditionally did not focus on transfer pricing. The new transfer pricing regime has, however, now provided them with the most important tool in the tax inspection process, i.e structured information.

The tax administration has set up dedicated technical teams to offer support to local tax inspectors. They also directly assist in tax inspections of large enterprises and in cases with technically complex transactions.

The inspection process

Although theoretically a transfer pricing tax audit can be carried out on a standalone basis, it is normally part of the general tax audit. Historically, tax audits were performed every four to six years. Today however, the STA relies more and more on profiled risk assessment models and processes to select taxpayers for priority screenings, both in the area of transfer pricing and beyond. As to transfer pricing, these assessments are linked to the business or industry of the taxpayer, results of previous tax audits, turnover and taxable income (losses), and of course the type and amount of the related party transactions.

The general transfer pricing documentation should be presented to a tax inspector only upon request. Nevertheless, all taxpayers subject to the documentation requirements must list the most significant transactions in the annual corporate income tax return, and this information is then automatically processed by the STA and used in the risk assessment procedures.

Tax audit experience

The focus on transfer pricing during a tax audit process has increased significantly since 2007. Tax inspectors have specifically been active in evaluating the substance behind intangible transactions, such as royalty, licence and franchise payments, (management support) services, and directors' remuneration (particularly in family-owned businesses).

BDO Spain has been involved in a number of inspections where taxpayers were requested to prepare and provide extensive information on the nature of the activities performed and the added-value provided by service providers or licensors of intangible assets. These information requests and the related discussions may be sweeping: in certain cases, tax inspectors not only required reasonable proof that a service could have benefited the taxpayer, but actually that it has. This is obviously contrary to the interpretation of the OECD

Guidelines.

Finally, it is worth mentioning that tax inspectors sometimes also requested “normal” transfer pricing documentation, even for years during which the formal documentation requirements were not enforceable. The underlying idea of these requests was basically to obtain more structured information on the relevant transactions, and in certain cases (management fees), the absence of standard documentation resulted in the tax inspector taking the position that the taxpayer had insufficiently proven the deductibility of expenses.

Future tax audits

The review of the taxpayer’s transfer pricing documentation will be a standard part of the tax audit procedures in the future. The starting point of the review will be to assess the formal compliance of the documents with the Corporate Income Tax Regulations; i.e. the tax inspector will verify whether all elements required by the Regulations are present in the documents. This is a non-technical yet fruitful exercise: non-compliance or partial compliance triggers tax penalties, even when no adjustments are made to the transfer prices. It is clear from our past experience that tax inspectors will also increasingly focus on the substance and added-value of services and other intangible transactions. In addition to the standard transfer pricing documentation, it is therefore highly recommended to maintain second-level, supporting documentation, such as correspondence between the taxpayer and the service provider, proof and copies of deliverables, timesheets, and any other documents or data that provide substance to the services received.

To date, tax inspectors have not focused too much on the technical review of the functional and economic analyses provided by the taxpayer. This is understandable, considering the recent introduction of the documentation requirements, hence the limited experience of tax inspectors. The STA are nevertheless actively increasing their technical knowledge based on past tax audits and the review of transfer pricing documents for fiscal years 2009 and 2010. It is expected that the number of technical transfer audits will grow significantly in the next two years.

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UNITED STATES OF AMERICA
DEVELOPMENTS IN TRANSFER PRICING RELATED TO THE NEW IRS SCHEDULE UTP , STATEMENT OF UNCERTAIN TAX POSITIONS

The IRS’s relationship with large taxpayers has been swiftly evolving in recent years. Through its recently restructured Large Business and International division (“LB&I”) the IRS has focused its attention more directly on large taxpayers, international issues, and transfer pricing. The new IRS Schedule UTP asks for information about tax positions – including transfer pricing – that affect the U.S. federal income tax liabilities of certain corporations.

Why is the Schedule UTP important?

At the AICPA meeting in Washington D.C. on 8 November 2011, the IRS Commissioner, Doug Shulman, spoke specifically about the Schedule UTP and commented, “It gets to the heart of information we need, while respecting a taxpayer’s internal analysis and deliberations. It moves us towards our shared objectives of efficiency, certainty, and consistency.”

In alignment with its focus on Schedule UTP, the IRS has set forth procedures that examiners must follow when examining any return. These procedures spell out “that the presence of the Schedule UTP with a return should not, in and of itself, be the sole factor used to determine whether or not to proceed with an examination.” Clearly the Schedule UTP is an essential portrait of the taxpayer’s tax positions and the IRS intends to gather information from the profile.

Who must file Schedule UTP?

For 2011 the following taxpayers, who issue or are included in audited financial statements, which have one or more reportable federal tax positions, and have assets equal to or in excess of USD 100 million are required to file Schedule UTP:
- Corporations required to file Form 1120, U.S. Corporation Income Tax Return
- Insurance companies required to file Form 1120-L or 1120-PC
- Foreign companies required to file Form 1120-F

For foreign corporations, the asset threshold is based on the worldwide assets of the corporation.

It is important to note that for 2012 the asset threshold for filers drops to include corporations with USD 50 million or more in assets. And in 2014 the threshold drops further to include corporations with USD 10 million or more in assets.

What must be disclosed in Schedule UTP?

The Schedule UTP asks for information about a taxpayer’s tax positions. A “tax position” is a position taken on the federal tax return that would result in an adjustment to a line item on that tax return - or would be included in a section 481(a) adjustment - if the position is not sustained. Schedule UTP filers are required to disclose, for those tax positions taken in a tax return for the current or a prior tax year:
- Each federal income tax position for which they or a related party has recorded a reserve (such as under FIN 48) in an audited financial statement.
- Each federal tax position for which they or a related party has not recorded a reserve in the audited financial statements because there is an expectation to litigate, and a determination has been made that the probability of settling with the IRS would be less than 50 percent. In other words, a federal tax position the corporation would intend to litigate and has concluded it will “more likely than not” prevail on the merits in litigation.

Some important definitions have been provided by the IRS and the Schedule UTP form instructions:
- Audited financial statements are defined as financial statements on which an independent auditor has

expressed an opinion (whether qualified, unqualified, disclaimed, or adverse) under GAAP, IFRS, or another country-specific accounting standard, including a modified version of any of the above (for example, modified GAAP).

Note that compiled or reviewed financial statements are not audited financial statements.

- A related party is defined as any entity that has a relationship to the corporation that is described in sections 267(b), 318(a), or 707(b), or any entity that is included in consolidated audited financial statements in which the corporation is also included.

- The unit of account, the level of detail used in analysing a tax position, should take into consideration the detail level at which the taxpayer prepares and supports the tax return position and the level at which the taxpayer anticipates addressing the issue with the IRS. Unit of account utilization by a GAAP or modified GAAP taxpayer, for reporting a tax position on Schedule UTP, must be the same unit of account used by the taxpayer for GAAP or modified GAAP.

Under what circumstances would something need to be disclosed in the Schedule UTP? And how is it disclosed?

If a reserve has been recorded on an audited financial statement, and the tax position is taken on a tax return for the current or prior year, the position needs to be disclosed on the Schedule UTP. In addition, tax positions taken on the return for which reserves were not recorded in the audited financial statements with an expectation to litigate and prevail on the merits, must be disclosed on the Schedule UTP. The IRS provides specific guidance in the UTP form instructions, that taxpayers are not required to disclose tax positions where no reserve was required for financial statement purposes, either because "the amount was immaterial for audited financial statement purposes, or that the tax position was sufficiently certain so that no reserve was required."

On Part I, each uncertain tax position should be assigned a number. The taxpayer must provide the primary IRC sections (up to three) relating to the tax position as well as the characterization of whether the position creates a permanent or temporary difference. If the tax position related to a tax position of a pass-through entity, the EIN of the passthrough entity should be provided (if foreign without an EIN, enter "F"). An indication should be made of whether the position is a "Major Tax Position" greater than or equal to 10 percent of the size of all reported UTPs. The tax positions should be ranked on the Schedule UTP by size, starting with the largest size first, based on the annual income tax reserve for each tax position. In addition to the number ranking, a letter must be assigned to each tax position, for example, the letter T is used to denote transfer pricing positions and the letter G is used for all other tax positions. Responses provided to the Schedule UTP should be concise and do not have to include country names.

On Part II, tax positions taken by the corporation in a prior year but not reported on a Schedule UTP filed with a prior year tax return should be reported. The reporting requirements for Part II are identical to Part I. For the tax year 2010 Part II was not used, but is being transitioned in for the tax year 2011.

On Part III, taxpayers are generally required to provide a concise description, not exceeding a few sentences, for each tax position disclosed in Part I of the Schedule UTP. "Available upon Request" is not considered an adequate description by the IRS. Relevant facts should be given to apprise the IRS of the identity of the tax position.

In coordination with other reporting requirements, the IRS will treat an entity as having filed Form 8275, Disclosure Statement, or Form 8275-R by filing a complete and correctly disclosed tax position on the Schedule UTP. The IRS provided clarification in Announcement 2010-75 that the Internal Revenue Code (IRC) section 6662(i) disclosure requirements will have been met with proper disclosure of tax positions on the Schedule UTP. However, the IRS has specified that this amnesty does not apply to disclosed positions that are also reportable transactions.

Conclusion

In the approximately 1,500 UTP Schedules received by the IRS during 2011, the top three code sections cited in Part I were Section 41 research tax credits, Section 162 trade and business expenses, and Section 482 allocation of income, including transfer pricing.
Taxpayers should take care when preparing, or choosing not to prepare, the UTP schedule. The Schedule UTP is the link between financial statements and tax returns, and impacts the policy for establishing reserves. Large taxpayers should implement processes to increase documentation and responsibility for uncertain tax positions, including those relating to transfer pricing positions.

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CURENCY 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 8 February 2012.

Currency unit	**Value in euros (EUR)**	**Value in US dollars (USD)**
Euro (EUR)	1.0000	1.31547
Hungarian Forint (HUF)	0.00343	0.00451
US dollar (USD)	0.76011	1.00000

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