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# TRANSFER PRICING NEWS

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## INTRODUCTION

Transfer pricing is increasingly influencing significant changes in tax legislation around the world. This 10th issue of BDO's Transfer Pricing Newsletter focuses on recent developments in the field of transfer pricing in Argentina, Canada and Malaysia. In this newsletter you will also find an interesting contribution about the recent case laws of China and Norway. Finally, there is an article from BDO US about the effect of transfer pricing adjustments on the customs value.

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# ARGENTINA

## RECENT DEVELOPMENTS

Argentina has adopted the arm's length principle and other similar OECD transfer pricing rules throughout the last decade. During 2010 and 2011 there was some important news in this field, especially in relation to different transfer pricing controversies. In addition, at the start of 2012, the Argentine Tax Authorities issued some fiscal and exchange rules in order to control and delimit service transactions.

Taxpayers are now analysing this new information. It is important to consider that under the Argentine legislation, transfer pricing returns and a transfer pricing study must be filed with the Tax Authorities each year. The new data will also likely impact transfer pricing planning and business restructurings that have effects in Argentina.

### Transfer pricing case decisions

The National Tax Court has ruled on transfer pricing issues in the following cases:

This list could be split into segments. The first three cases relate to old transfer pricing rules, but the criteria and the assumptions generated in those controversies can be extrapolated to the law applicable today. These controversies concern manufacturing companies that involve the export of tangible goods to related parties.

The other decisions relate to the current transfer pricing legislation. In these cases the entities are manufacturing companies as well as agriculture commodity trading companies and the main oil and gas company of Argentina. In general terms, in these cases the Argentine Tax Authorities challenged some comparable companies used in the taxpayer's transactional net-margin method (TNMM) documentation and some adjustments performed to the tested party in order to improve the comparability for the use of the TNMM (i.e. accounting adjustments, capacity utilisation adjustments, extraordinary bad debts adjustments, extraordinary severance pay adjustments, etc.). Furthermore, the Argentine Tax Authorities objected to the use of the TNMM in some cases where internal comparables could be used (by applying a comparable uncontrolled price (CUP) or cost plus). Finally, in the commodities cases, the local government questioned the date of the transactions performed by the trading companies for the application of the CUP. According to these cases, the transactions will have a 'fair date' only when there is an agreement supporting this fact.

In addition, some legal cases analyse the use of the range and/or the inter-quartile range. In general terms, the National Tax Court decisions are favourable to the taxpayer. It is important to remember that in Argentina the use of inter-quartile ranges is currently applicable (General Resolution #1122 provides for the procedure to apply the arithmetic methodology) but during the fiscal years in which the controversies mentioned above occurred, the rules were not completely clear.

| Company | Industry | Date | Result |
|---|---|---|---|
| 1. Laboratorios Bagó S.A. | Pharmaceutical | 11/2006 | +for taxpayer |
| 2. Daimlerchrysler Argentina S.A. | Automotive | 09/2009 | +for Tax Authorities |
| 3. Volkswagen Argentina S.A. | Automotive | 12/2009 | +for taxpayer |
| 4. Aventis Pharma S.A. | Pharmaceutical | 02/2010 | +for taxpayer |
| 5. Volkswagen Argentina S.A. | Automotive | 07/2010 | +for taxpayer |
| 6. Nobleza Piccardo S.A.C.I.Y F. | Cigars & Tobacco | 07/2010 | +for taxpayer |
| 7. Alfred C. Toepfer Internacional S.A. | Agricultural commodities | 07/2010 | +for Tax Authorities |
| 8. Cargill S.A.C.E.I. [1] | Agricultural commodities | 02/2011 | +for taxpayer |
| 9. Toyota Argentina S.A. | Automotive | 04/2011 | +for taxpayer |
| 10. Nidera S.A. | Agricultural commodities | 09/2011 | +for Tax Authorities |
| 11. YPF S.A. | Oil & Gas commodities | 12/2011 | +for taxpayer |
| 12. Oleaginosa Moreno S.A.C.I.F.I.A | Agricultural commodities | 03/2012 | +for Tax Authorities (partial) |
| 13. Boehringer Ingelheim S.A. | Pharmaceutical | 04/2012 | +for Tax Authorities (partial) |

[1] *This case was heard and decided by the National Court of Appeals dealing with Criminal Economic matters.*

It is also important to mention that the results of these cases were closely related to the production of sufficient evidence. In the cases in which the taxpayer offered strong evidence supporting his/her position, this had a direct impact on the decision of the National Tax Court. Another important conclusion is that during the last year, court decisions on transfer pricing issues increased significantly. Additionally, the National Tax Court is working on several transfer pricing cases to be decided in the near future. Taxpayers therefore have to be prepared and aware of this situation.

### Service transactions

Argentina has no specific transfer pricing rules for intra-group service transactions. Therefore, general regulations regarding transfer pricing apply to such transactions. Taxpayers in Argentina therefore have to pass the "benefit test" and then prove the "at arm´s length" charge (i.e. the transactions between a local company and a foreign related party have to be conducted as if the parties were not related, provided that the terms and conditions of such transactions are consistent with habitual market practices between independent parties). It is important to mention that in Argentina the tested party must be the local company.

Companies that conduct transactions with foreign related parties must file transfer pricing documentation (i.e. transfer pricing studies, transfer pricing returns and a CPA written accounting certification).

Through general resolution #3276, the tax authorities (AFIP) established a reporting regime that requires the declaration of any export and import of services involving a resident of Argentina. From 1 April 2012, this includes information related to services to the "Single Window for Foreign Trade".

Accordingly, Argentine residents rendering or receiving services from abroad have to complete an "Anticipated Services Return" (*Declaración Jurada Anticipada de Servicios,* or *DJAS*) within the "Single Window for Foreign Trade" available at AFIP's website (www.afip.gob.ar). The taxpayer must also submit a copy of the invoices and the service agreements.

Each DJAS will be assigned an identification number which must then be reported and recorded in the "System of Foreign Exchange Control", which is a condition for carrying out the subsequent exchange operation.

The above-mentioned General Resolution stipulates that services provided by foreign entities to Argentine residents for more than USD 100,000 (or instalments amounting to more than USD 10,000) are to be included in this regime. When services are rendered for longer periods, the sum of the amounts due for the entire term of the contract should be considered. Contracts for undetermined amounts should be reported in all cases. In addition, services provided by Argentine residents to foreign entities should be reported in all cases.

With regard to the exchange rules for services, it is important to take into account, among other, Communication "A" 5264, 5295 and 5330 issued by the Central Bank of Argentina (*Banco Central de la República Argentina* or *BCRA*), which contains the following provisions:

**Export of services**: The income in foreign currency earned by residents in Argentina from the export of services must be brought to the local exchange market within 15 working days of the date on which the sums were collected either abroad or at home, or credited in bank accounts abroad.

**Import of services**: The prior approval of the BCRA will be required when payments are made to a foreign beneficiary in relation to any of the following:

- other information and computer services;
- business services, professional services and technical services;
- royalties;
- patents and trademarks;
- premiums for players loaned;
- copyright;
- personal, cultural and recreational services;
- payment of commercial bonds for exports of goods and services;
- commercial commissions;
- exploitation of film rights, foreign video and audio; and
- technology transfer services established by law 22.426.

where the beneficiary is a person or entity related (either directly or indirectly) to the local debtor, or a person or entity located in a country considered a low-tax jurisdiction, provided (i) the amounts payable are higher than USD 100,000 per calendar year; (ii) each installment amounts to more than USD 10,000; or (iii) the amount is not determined.

Communication "B" 10321, issued by the BCRA, also establishes some formats for financial entities involved in foreign exchange transactions. One of these formats refers to payments for services. In the case of transactions between related parties, the BCRA will specify the documentation (information used, sources and estimation method used) to be filed in order to prove that the operations were conducted at market value and were economically reasonable for the customer. It will be necessary to explain the estimation method and sources of information used.

When the foreign beneficiary is a person or entity residing, incorporated or domiciled in a low-tax jurisdiction, or when an account is opened in such jurisdictions, such a person or entity should provide additional data, including: address of the beneficiary, account number abroad, background of the person abroad who provided the services, etc.

### Comments

The transfer pricing environment in Argentina is showing intense activity. The increasing number of court rulings and the new rules together portray a changing scenario that requires the taxpayer's awareness. In addition, the number of transfer pricing audits carried out by the Argentine Tax Authorities is growing. Taxpayers should therefore be ready to respond to the more detailed and complex transfer pricing rules and requirements.

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# CANADA

## CLARIFICATION ON THE TREATMENT OF SECONDARY TRANSFER PRICING ADJUSTMENTS

On 29 March 2012, the Canadian Minister of Finance tabled the 2012 Canadian Federal Budget. In brief, the action plan of the majority Conservative government is to balance the budget in the medium-term, which involves cuts to operating budgets, while also encouraging long-term economic growth, with a focus on job creation and major changes impacting innovation in Canada. In respect of transfer pricing, the 2012 Budget proposed improvements to Canada's system of international taxation, and specifically provides some clarity on secondary transfer pricing adjustments. The following provides an overview of the impact to the Canadian transfer pricing regime.

### Background

Canadian transfer pricing rules are provided in section 247 of the *Income Tax Act* (Canada) (the Act). In 1999, the Canada Revenue Agency (CRA) issued Information Circular 87-2R, *International Transfer Pricing*, CRA [1999] (IC 87-2R) with the purpose of providing administrative guidance with respect to the application of the Canadian transfer pricing rules.

In the context of secondary adjustments, prior to the 2012 Budget, although the CRA has provided some administrative guidance (paragraphs 211 to 213 of IC 87-2R and *Transfer Pricing Memorandum TPM–02: Repatriation of funds by non-residents – Part XIII assessment*), there has been no clear legislative policy stated in the Act advising on the treatment of secondary adjustments arising from primary transfer pricing adjustments. The proposed amendments discussed below are viewed as positive additions to the Canadian legislation, and provide Canadian taxpayers with clear direction with respect to the treatment of secondary adjustments.

### Primary Adjustments

Where the CRA determines that an amount paid by a Canadian taxpayer to a related non-resident entity is not at arm's length and is excessive (i.e. the Canadian taxpayer has paid too much), subsection 247(2) of the Act allows the CRA to adjust the price of an inter-company transaction if the price differs from what would be expected if it was conducted at arm's length. Subsection 247(2) of the Act permits the CRA to adjust the amount downward, resulting in a transfer pricing adjustment.

For example, Canco, a Canadian company purchased tangible goods from its U.S. subsidiary, USco, at a price of CAD 10,000. However, independent entities dealing at arm's length under comparable circumstances would have entered into a similarly structured transaction and would only have paid CAD 2,000 for the tangible goods. In this instance, Canco is deemed to have paid the lower arm's length price of CAD 2,000. The CAD 8,000 excess over the arm's length price will be disallowed as a deduction where Canco has deducted the cost of the goods in computing its income. This adjustment is commonly referred to as a "primary adjustment", or the disallowed portion of the price paid to the related non-resident. The impact of a transfer pricing adjustment is an increase in the Canadian taxpayer's income for tax purposes by the amount of the adjustment. In this example, Canco's income for tax purposes increases by CAD 8,000.

### Clarification on Secondary Adjustments and Proposed Amendments

In the instance of a Canadian corporation subject to a primary adjustment, the CRA will likely treat the amount of the primary adjustment as a shareholder benefit under subsection 15(1) of the Act, which is deemed to be a dividend subject to withholding tax under paragraph 214(3)(a) of the Act. This is referred to as a "secondary adjustment". In the example above, the excess amount of CAD 8,000 paid by Canco to USco would be characterised as a deemed dividend subject to withholding tax.

The 2012 Budget proposes to amend section 247 of the Act to confirm that secondary adjustments will be treated as dividends for Part XIII[1] withholding tax purposes. If the related non-resident entity is a controlled foreign affiliate of the Canadian taxpayer, the provision is not applicable.

Further, the 2012 Budget proposes to eliminate the deemed divided if the amount equal to the primary adjustment is repatriated to the Canadian corporation by the related non-resident. The proposed amendments codify existing CRA administrative guidance with respect to situations in which a non-resident entity repatriates the excess amount to the Canadian corporation.

### Next Steps and Conclusion

The amendments discussed above will apply to transactions that have occurred or will occur on or after 29 March 2012.

In the past, the CRA has been inconsistent in its treatment of secondary transfer pricing adjustments, which may be due in part to the complexity of the structure of many Canadian companies. The amendments are welcome additions since they provide specific legislative policy with regard to secondary adjustments that were previously only addressed under CRA's administrative guidelines. Although it is acknowledged that the manner in which the provisions have been drafted in the 2012 Budget will still likely lead to controversy, the amendments are a step in the right direction and are somewhat advantageous to Canadian taxpayers in respect of secondary transfer pricing adjustments and withholding tax.

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[1] *Part XIII tax is a withholding tax imposed on certain amounts paid or credited to Canadian non-residents. Examples of these amounts include pensions, annuities, management fees, interest, dividends, rents, royalties, estate or trust income, and payments for services when a Canadian taxpayer pays or credits these amounts to individuals (including trusts) or corporations that are not resident in Canada.*

# CHINA

## SPECIAL TAX ADJUSTMENTS ON SHARE TRANSFER INCOMES BY NON-RESIDENT ENTERPRISES

Article 47 of the *Enterprise Income Tax (EIT) Law of the People's Republic of China* stipulates that where an enterprise implements an arrangement without reasonable commercial purpose, the tax authority has the right to make special tax adjustments. The State Administration of Taxation (SAT) issued '*Implementation Measures of Special Tax Adjustments (Provisional)' (Guo Shui Fa [2009] No. 2 or Circular #2)* in early 2009. Circular #2 further stipulates that the tax authorities can carry out a general anti-tax avoidance investigation where there is an abusive tax arrangement, and withdraw the tax benefits the non-resident enterprise gains from such an arrangement by re-characterising its tax arrangement based on its economic substance. The tax authorities can refuse to recognise the existence of the offshore intermediate holding company established in a tax haven, with the primary purpose of reducing, avoiding or deferring tax payments.

At the end of 2009, the SAT issued '*Strengthening the Administration of EIT Liability on Incomes of Non-resident Enterprises from Transfer of Equity Interests*' *(Guo Shui Han [2009] No. 698 or Circular #698)*. Circular #698 specifies that for the companies which 'indirectly transfer the equity interests in a Chinese resident enterprise by abuse of organisation form for an unreasonable commercial purpose to avoid paying the EIT', the tax authority may apply 'look-through' principles by denying the existence of the offshore intermediate holding company where there is an abusive tax arrangement, and re-characterising the indirect transfer as a direct transfer of equity interests in a Chinese enterprise, thus levying the EIT on capital gains derived from such a transfer. Circular #698 also stipulates that where the non-resident enterprise transfers the equity interests in a Chinese enterprise to its affiliate(s) and the transfer price thereof is not in line with the arm's length principle which results in less taxable income, the tax authorities have the right to adjust using reasonable methods.

### Penalties as a result of Transfer Pricing Adjustment

A special interest levy applies to underpaid taxes where a transfer pricing adjustment is made. According to Article 48 of the *Enterprise Income Tax Law*, where the tax authorities make tax adjustments resulting in overdue taxes, the overdue taxes must be settled and subject to interest stipulated by the State Council.

A daily interest levy is applied to the amount of overdue tax in relation to transactions that took place on or after 1 January 2008. The interest period is from 1 June after each tax year for which an adjustment is made until the date of settling the overdue tax.

The interest rate is the basic Reminbi lending rate for the tax year for which an adjustment is made, as published by the People's Bank of China, plus a 5% penalty interest rate. Where the enterprise provides contemporaneous documentation (unless exempted from its preparation) and other information in accordance with the *Enterprise Income Tax Law, the Enterprise Income Tax Law Implementing Rules and Circular [2009] 2*, the 5% penalty interest rate does not apply. However, the penalty interest may apply when the adjusted related party transaction amount exceeds the contemporaneous documentation preparation exemption threshold; even if the enterprise acted in good faith but mistakenly believed that it was exempt from the contemporaneous documentation requirement.

The aforesaid interest charges are not tax-deductible when computing taxable income.

### Appeal procedure for a Transfer Pricing Adjustment

The taxpayer can challenge a transfer pricing adjustment by applying for administrative reconsideration. However, the taxpayer is required to settle the amount of overdue tax as determined by the tax authority within the stipulated time. The adjustment is reconsidered by the tax authority one level senior to the tax authority that issued the disputed transfer pricing adjustment. The reconsidering institution will decide whether to accept the case within five working days of the application. The reconsidering institution should deliver its decision within 60 days of accepting the reconsideration application, which may be extended for a maximum of 30 days if the reconsideration decision is unsatisfactory. The taxpayer may appeal to the People's Court within 15 days of the receipt of the reconsideration decision.

### Case Analysis - a case in Shanxi Province

According to recent Chinese media reports, the Jincheng State Tax Bureau (Jincheng STB) in the Shanxi province recently collected tax amounting to CNY 403 million from the indirect share transfer in a Chinese coal enterprise by a BVI company. The disposal was effected through the disposal, by the BVI Company, of a Hong Kong company, which held the equity interest in the Chinese enterprise. The very substantial amount of tax involved makes this the single largest tax imposition in an offshore indirect transfer case to date, exceeding even the amount collected in the Master Kong Beverages case of 2011, in which CNY 306 million was collected, and the Evergrande case in January of this year, in which CNY 299 million was collected. The Jincheng case comes at a time when the PRC tax authorities are vigorously enforcing Circular 698, and draws attention to a number of recent developments of note in the application of the measure.

### Introduction to the Jincheng case

A tax imposition pursuant to Circular #698 can be made based on the general anti-avoidance rule of the PRC Enterprise Income Tax (EIT) Law. Offshore indirect transfer arrangements involving an abusive use of organisational forms, in respect of which the taxpayer is unable to demonstrate economic substance in the offshore company, may be re-characterised as a direct disposal of the underlying equity interest in the Chinese company.

The Chinese coal enterprise in this case (the Target) was originally established in Shanxi province in 2000 as the first large-scale Sino-foreign joint venture coal enterprise in China. A BVI company (the Transferor) owned 56 percent of the equity in the Target through a series of acquisition transactions over several years. The Target shareholding was held by Transferor's wholly-owned Hong Kong subsidiary (Holdco).

In March 2011, the Jincheng STB became aware that Holdco had been transferred by Transferor to a coal industry holding company based in Hong Kong (the Transferee) for a consideration of USD 669 million. It appears that the transaction was not reported to the Jincheng STB, as required under Circular #698. Once the Jincheng STB became aware of the transaction, it issued Notices of Tax Matters to Transferor and Transferee with a view to obtaining documentation relevant to the transfer, and carried out on-site inspections at Target's premises. The Jincheng STB apparently concluded that the transaction involved an abusive use of organisational forms and that Holdco exhibited insufficient economic substance, as they proceeded to impose tax on the Transferor pursuant to Circular #698.

Having liaised with the tax representatives of Transferor for a period, and with demanded taxes remaining outstanding, Jincheng STB informed Transferee that they were to withhold the requisite amount of tax from the consideration as yet unpaid to Transferor. This led to Transferor finally agreeing to settle CNY 403 million in taxes.

### The Jincheng case and the evolution of Circular #698

The CNY 403 million taken by the Jincheng STB is the largest Circular #698 settlement yet reported, and comes on the heels of reports that applications of Circular #698 are bringing in ever-larger amounts. In the last year alone, tax collected by the PRC tax authorities nationwide on indirect equity transfers by non-resident enterprises totalled CNY 1.04 billion, having increased fourfold over the last year. In this regard, it has been noted that the global economic downturn caused a number of overseas enterprises to dispose of their investments in China, thereby driving up the number of Chinese equity disposals, both direct and indirect.

According to Article 15 of *Provisional Measures on Administration of Withholding at Source of Income Tax of Non-resident Enterprises(Guo Shui Fa [2009] No. 3)*, where both parties in an equity transfer are non-resident enterprises and the transaction is carried out overseas, the non-resident enterprise which obtains the income must declare and pay tax on its own to the tax authorities in charge at the location of the domestic enterprise whose equity is transferred, or appoint an agent to declare and pay tax on its behalf to the tax authorities in charge at the location of the domestic enterprise whose equity is transferred. The domestic enterprise whose equity is transferred must assist the tax authorities to collect tax from the non-resident enterprise. In the Jincheng case, the Jincheng STB leveraged its position vis-a-vis Transferor by instructing the Transferee that they would be obliged to withhold tax. Such a stance on the part of the tax authorities is known to have been taken in previous cases, although a charge to tax, pursuant to Circular #698, is specifically assessed directly on the transferor. Thus, the Jingcheng STB's adopted position appears to be grounded upon the general provisions of the PRC tax collection laws.

The references in the media reports to a late payment surcharge and penalties being considered by the Jincheng STB is a matter of note, as it had been questioned whether the PRC tax authorities would, in practice, impose penalties on the transferor in addition to the tax collected for the purposes of Circular #698. If and when further case details emerge, the basis on which the penalties, if any, have been arrived at will be a matter of some interest to investors.

While it is not known precisely how the Jincheng STB obtained the information which allowed them to take action against the Transferor, it is apparent that local and state tax authorities are making efforts to become more proficient at collecting information relevant to detection and pursuit in the context of Circular #698 tax impositions. The SAT and the State Administration for Industry and Commerce have established an information sharing platform for details of equity transfers in this year. Independently, at a regional level, the recently established co-operation mechanism between the Anhui State Tax Bureau and the Anhui Bureau of Commerce involves the latter supplying the former with equity transfer approval documents, and could well be adopted by other regions. Tax authorities are also increasingly showing their adeptness at collecting information from public sources (such as listed company annual reports and stock exchange announcements) to pursue claims.

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# MALAYSIA

## LATEST DEVELOPMENTS ON TRANSFER PRICING AND ADVANCE PRICING ARRANGEMENTS

There have been some recent developments on transfer pricing (TP) as well as Advance Pricing Arrangements (APA) in Malaysia.

### Income Tax (Transfer Pricing) Rules 2012

Further to the Transfer Pricing Guidelines (TP Guidelines) issued by the Malaysian Inland Revenue Board (MIRB) on 2 July 2003 and the specific TP legislation, namely Section 140A of the Income Tax Act 1967 (ITA), which was effective from 1 January 2009, the Income Tax (Transfer Pricing) Rules 2012 (TP Rules) have now been issued. In essence, the TP Rules provide various clarifications on the application of Section 140A.

The salient points of the TP Rules are as follows:

- Effective retrospectively from 1 January 2009.
- A person who enters into a controlled transaction is required to prepare contemporaneous TP documentation. The TP documentation has to be put in place when developing or implementing any controlled transaction. Where there are material changes, the documentation should be updated prior to the due date for furnishing a return for that year of assessment. This emphasises the need for TP documentation to be up-to-date.
- Consistent with the TP Guidelines issued on 2 July 2003, the traditional transactional methods (i.e. Comparable Uncontrolled Price Method, Resale Price Method or Cost Plus Method) is preferred over the transactional profit methods (i.e. Profit Split Method or Transactional Net Margin Method) in determining the arm's length price of a controlled transaction.
- The Director General (DG) is empowered to disregard and re-characterise/make adjustments to the structure of the controlled transaction under the following circumstances:
  - the economic substance differs from its form; or
  - where the arrangements made, viewed in totality, differ from those which would have been adopted by independent persons.
- The application of the arm's length price methodology in the following transactions is also explained in the TP Rules:
  - intra-group services;
  - cost contribution arrangement between a person and its associated person;
  - sale or licensing of intangible property; and
  - interest on financial assistance.
- An arm's length interest rate must be determined for financial assistance provided by a person in a controlled transaction. "*Financial assistance*" includes a loan, interest bearing trade credit, advance or debt and the provision of any security or guarantee.
- Where the DG has reason to believe that the controlled transaction is not at arm's length, the DG may make an adjustment to reflect the arm's length price or interest rate for that transaction.

The issue of the TP Rules and Section 140A of the ITA with effect from 1 January 2009 highlights the MIRB's increased focus/scrutiny on TP issues in related party transactions. It is therefore vital for taxpayers to understand the implications of TP related rules and legislation. Taxpayers must now ensure that they have proper pricing and TP documentation in place for all related party transactions prior to the tax filing due date.

### Income Tax (Advance Pricing Arrangement) Rules 2012

Further to the introduction of Section 138C of the ITA concerning APA which was effective from 1 January 2009, the Income Tax (Advance Pricing Arrangement) Rules 2012 (APA Rules) have now been issued. Similar to the TP Rules, the APA Rules provide clarification on the application of Section 138C of the ITA.

An APA represents an agreement made in advance between the tax authority and a taxpayer on the arm's length price of their international dealings with related parties for a particular period of time (generally 3 to 5 years). It avoids disputes arising from TP audits which are both time-consuming and costly.

The salient points of the APA Rules are as follows:

- Taxpayers who carry on cross-border transactions may apply for an APA in relation to a covered transaction for specified terms and conditions.
- The APA Rules deal with unilateral, bilateral and multilateral APAs.
- The arm's length TP will be ascertained in accordance with the relevant TP Rules and legislation.
- The covered period under an APA will be a minimum of 3 years of assessment and a maximum of 5 years of assessment.
- The taxpayer must furnish the DG with a compliance report for each year of assessment of the covered period, within 7 months from the date following the close of the accounting period which constitutes the basis period for that year of assessment.
- A rollback may be requested by the taxpayer if the proposed TP methodology is relevant to the prior years' assessment and the facts and circumstances of the prior years are substantially the same.
- All information obtained by the DG or the Competent Authority in respect of the APA process is subject to the confidentiality provisions of the ITA and the articles on Exchange of Information of the arrangement made under Section 132 of the ITA.

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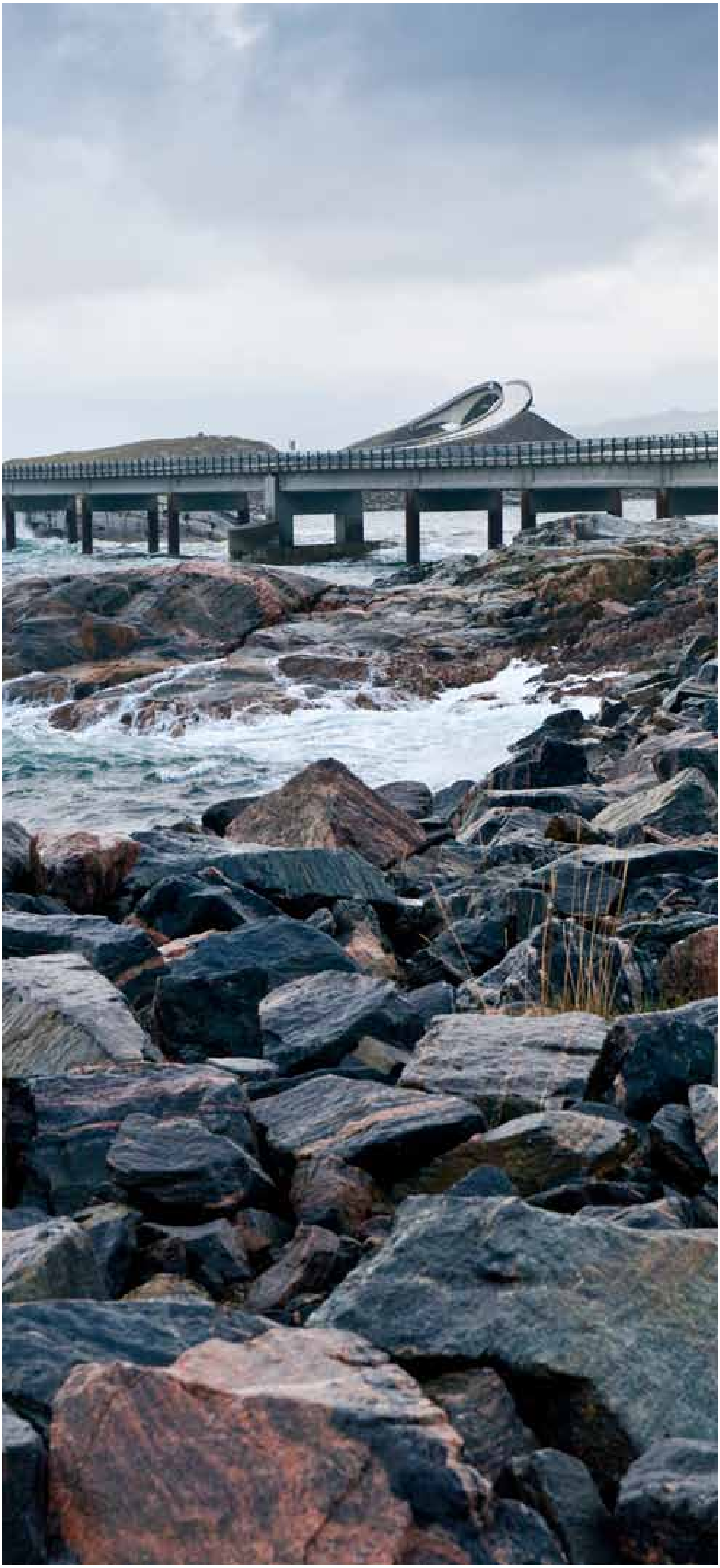
# NORWAY

## SUPREME COURT RULES ON DELL



Over the last decade we have seen that the Norwegian tax authorities are greatly increasing their focus on complex transfer pricing cases. In common with the recent general transfer pricing focus in comparable European countries, the Norwegian authorities recognise the revenues at stake and are determined to invest both manpower and technological resources to secure the Norwegian tax base.

The Dell case is a good example. In a unanimous decision issued in December 2011, the Norwegian Supreme Court ruled that a Norwegian commissionaire (Dell AS) did not create an agency permanent establishment in Norway for its foreign principal company (Dell Products Ltd. - another subsidiary in the Dell Group, registered in the Netherlands but for tax purposes resident in Ireland).

### Facts

Dell AS, on behalf of Dell Products Ltd., was responsible for the sales and marketing of Dell products to public bodies and corporate customers in Norway. To govern the contractual relationship between the principal and its subsidiary, the companies had entered into an ordinary commissionaire agreement. Under the agreement, Dell AS sold products in the Norwegian market in its own name, but on account of its foreign principal, Dell Products Ltd., which also bore the associated risk.

From a tax perspective, the contractual relationship resulted in profits being distributed to the Irish tax-resident entity and being taxed in Ireland. The Norwegian subsidiary was "only" entitled to a commission fee, taxable in Norway.

After performing a tax audit, the Norwegian tax authorities challenged this agreement. They claimed that the Norwegian subsidiary constituted a permanent establishment (PE) in Norway of its foreign principal under the 'dependent agency' rule in the double tax agreement between Ireland and Norway. Consequently, Dell Products Ltd. was considered liable to pay tax in Norway for a significant share of the profits from the activities performed by Dell AS in Norway. The tax authorities used the profit split method, and allocated 60 percent of the income to Norway.

Both the Municipality Court and the High Court ruled in favour of the tax authorities, and accepted the allocation made.

## The Supreme Court ruling

Under the provisions of the Norwegian Tax Act the authorities have the right to tax a foreign person on capital and income of a business which he participates in or carries out in Norway. Also, a business that is operated in or managed from Norway is taxable here.[1] The decisive issue before the court was whether or not the tax treaty between Norway and Ireland prevents Norway from executing this right. In other words, did Dell AS constitute a PE in Norway for Dell Products Ltd., thus allowing the Norwegian authorities to tax Dell Products Ltd. for a share of its revenues? The relevant article in question was Article 5(5) – the 'dependent agent' rule.

To constitute a PE under article 5(5), Dell AS must meet two conditions:

1. It must be a dependent agent; and
2. It must have, and habitually exercise, an authority to conclude contracts in the name of (Norwegian: "på vegne av" which literally translates as "on behalf of") Dell Products Ltd.

In the lower courts, Dell Products also claimed that the commissionaire had to be regarded as an independent agent under article 5(6) of the treaty. This was not addressed in the Supreme Court, probably because it had little significance since this provision under the OECD commentary is inserted for the sake of clarity and emphasis.[2] In its decision, the Supreme Court clearly stated that, under Norwegian law, a commissionaire does not legally bind its principal.[3] The agreement between the customer and the commissionaire does not give the customer any rights with respect to the principal in relation to the sale. This was strongly asserted by Dell and accepted by the tax authorities.

However, the authorities claimed that, although Dell AS did not *legally* bind Dell Products, they did so "in reality". In other words, the authorities based their interpretation of the tax treaty on a purposive approach, rather than on the actual wording of the treaty. The Supreme Court did not agree with this approach.

In the Zimmer case, the French Supreme Tax Court (Conseil d'Etat) concluded that a standard commissionaire agreement does not result in the principal being legally bound by sales agreements between the commissionaire and a third party and cannot, in principle, be deemed to constitute a permanent establishment

> "unless it results, either from the terms of the commissionaire agreement itself, or from any other finding resulting from the investigation, that despite the qualification as commission agreement given by the parties to the agreement, the principal is personally bound by the contracts signed with third parties by the commissionaire, which in such a case must be regarded as its representative and constitute a permanent establishment."

Contrary to the decision of the High Court, but hardly unexpected, the Norwegian Supreme Court emphasised the importance of the French Zimmer case ruling[4] and the similarity between Norwegian and French law with regard to the commissionaire concept.

Based on both domestic and international sources of law, the Supreme Court concluded that the Norway-Ireland tax treaty (identical to the OECD Model Tax Convention on Income and Capital article 5(5)) required the subsidiary to legally bind its principal for the relevant PE condition to be met.

## Comments

In our view, the Norwegian tax authorities chose a difficult case to take to the courts on the issue of an agency permanent establishment. Domestic law clearly states that a commissionaire does not legally bind its principal towards the customer, similar to the position under French law.

The ruling in the Dell case shows that the risk of a commissionaire constituting a PE for its principal is low or non-existent in Norway, provided that the parties apply and follow a standard commissionaire agreement. It might even be of interest for other jurisdictions.

Note that the decision has little bearing for structures where the agent is a commercial agent, and not a commissionaire. The concept for the commercial agent is that it should only collect orders for the principal, and the agreement is entered into between the principal and the customer directly. A greater participation from the agent, when the sales contract is entered into, can still lead to a PE in the agent's jurisdiction.

Indirect allocation of profits to a PE, and the profit split method (between related companies) seems to have become increasingly fascinating to the Norwegian tax authorities. To us it might seem somewhat aggressive to allocate 60% of the income to Norway, as was done in this case. However, this approach was poorly treated in the lower courts, with the result that in the Dell case it is still an open issue.

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[1] *The Norwegian Tax Act § 2-3 (1) b)*

[2] *OECD Commentary no 36*

[3] *The Norwegian Act on commission § 56*

# UNITED STATES OF AMERICA

## NEW POLICY ALLOWS FOR U.S. DUTY REFUNDS ON DOWNWARD TRANSFER PRICING ADJUSTMENTS

On 30 July 2012, after more than a decade of review and consideration and just two months after the formal announcement of its imminent implementation, U.S. Customs & Border Protection (CBP) initiated a new policy to allow customs duty refunds for downward transfer price adjustments. At its core, the new policy effectively permits the transaction value (i.e. the price paid or payable) to be used for imported goods when based on a price determined pursuant to a formula established by a transfer pricing method. CBP now permits duty refunds (or determines additional duties) when customs values are revised due to post-importation transfer pricing adjustments. This new policy is arguably the most important development in U.S. customs valuation law in recent history and should facilitate enhanced harmonisation of the treatment of transfer pricing adjustments between the U.S. Internal Revenue Service (IRS) and CBP. For U.S. taxpayers engaged in regular trade with related parties, this development opens the door to more accurately determine, report, and pay duties on the final transfer price actually paid (or payable) for imported goods.

### Foundations: Transfer Price ≠ Customs Value

Under U.S. customs valuation laws and regulations there are various methods that importers can employ to appraise and declare the value of their imports properly. The most common method of customs valuation (and first in the hierarchy) is the "transaction value" method. In general, the transaction value method is defined as the "price actually paid or payable for the merchandise when sold for exportation to the United States," plus certain statutory amounts. In practice, this allows an importer to declare the value of its imported goods on the amount(s) listed in the financial invoice.

When that invoice price is adjusted at some later date to align overall financial results with a determined arm's-length range for income tax purposes, either as a result of company financial planning or a requirement from a taxing authority, the resulting customs value may also be impacted. Such adjustments may be either prospective or retrospective, depending on the facts, circumstances, and objectives of any given situation. When they occur retrospectively and relate to goods previously imported and cleared through the customs entry process, U.S. importers typically are required to report the adjustment to CBP and pay any additional duties that may be owed. The principal reason for this requirement is that the adjustment to the value originally declared is, in effect, the final element necessary to appraise the imported merchandise properly.

Historically, CBP viewed upward and downward adjustments differently. For upward adjustments, the importer had to pay additional duties to CBP. For downward adjustments, CBP denied duty refunds to the importer. This position was based on CBP's view that the U.S. customs valuation statute required it to disregard rebates or other decreases to the price actually paid or payable that is made between the buyer and the seller after the date of importation. In a broader interpretation of the same, CBP also has ruled that in some cases "prices subject to an adjustment, either upward or downward, cannot represent transaction value."[1] In practice, the only way adjustments could be made with the importer still employing the transaction value was to apply a fixed formula at import with which CBP agreed.

The element of "control" over the transaction by the seller, buyer, or some future event or occurrence (not influenced by the seller or buyer) also factored into what CBP considered a formula. In its view, a formula needed to be fixed "so that a final sales price could be determined at a later time on the basis of some future event or occurrence over which neither the seller nor the buyer have any control."[2]

**New policy: Transfer Price ≈ Customs Value**

On 30 May 2012, CBP issued Headquarters Ruling Letter (HRL) W548314, which revoked an earlier ruling from 2001 (HRL 547654) and sets out CBP's new policy on the application of transaction value in the context of post-entry adjustments, with effect from 30 July 2012. It is now CBP's position that, subject to certain conditions, the transaction value method of appraisement will not be precluded when a related party sales price is subject to post-importation adjustments that are made pursuant to formal transfer pricing policies and specifically related (directly or indirectly) to the declared value of the merchandise. These adjustments, whether upward or downward, are to be taken into account in determining transaction value.

In effect, this new policy allows a transfer pricing policy to serve as an objective formula to be applied using transaction value as the method of appraisement for post-importation adjustments. CBP now requires the following criteria to be applied before it will accept post-entry adjustments in sales between related parties:

1) A written inter-company transfer pricing determination policy (prepared in a manner consistent with section 482 of the Internal Revenue Code), which sets out how the transfer price is to be determined, is in place prior to importation;
2) The importer/buyer is the U.S. taxpayer who uses its transfer pricing policy in filing its corporate income tax returns, and any adjustments resulting from that policy are reported or used by the taxpayer in filing its income tax return;
3) The company's transfer pricing policy specifies how the transfer price and any adjustments are determined with respect to all products covered by the policy for which the value is to be adjusted;
4) The company maintains and provides accounting details from its books and/or financial statements to support the claimed adjustments in the U.S.; and
5) No other conditions exist that may affect CBP's acceptance of the transfer price.

While all of these criteria must be met, no single one will be determinative, and CBP's finding regarding whether or not an objective formula exists will be made on a case-by-case basis. Moreover, importers still will be required to demonstrate that transaction value is acceptable under the circumstances of the sale test or the test values test. Evidence sufficient to meet only one test is required, but it is cautioned that CBP will often reject circumstances of sales analyses because they contain statements that are not supported by evidence, and the test values test is difficult to apply, given the lack of information available to the importer (e.g. competitors' prices in sales to unrelated U.S. buyers, supplier costs and profits, etc.).

**Next Steps for Taxpayers**

For taxpayers that make or expect to make post-entry transfer pricing adjustments related to inter-company merchandise trade transactions, the new CBP policy is a welcome development, but it is critical to be diligent when leveraging this important opportunity. In view of the above, we recommend that taxpayers take action to:

– Identify potential duty savings that may be available from downward adjustments to the customs value. Examining past and planned transfer pricing adjustments against customs entries and duty payments will facilitate the determination of possible duty recovery/savings.
– Review current customs valuation methodology to ensure compliance with CBP requirements, and prepare customs-specific supporting documentation to demonstrate that the transaction value is acceptable.
– Update/amend existing transfer pricing policies to include the five criteria noted above. The new policy considers only transfer pricing adjustments, which are otherwise acceptable for customs purposes, but does not permit taxpayers to use transfer pricing studies to support customs values.
– Apply for participation in CBP's reconciliation program to correct declared customs values following retrospective transfer pricing adjustments.[3] Reconciliation permits the submission of provisional values for imported goods and the subsequent declaration of the final value up to 21 months following import.

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*[1] HQ H021424 (Feb. 3, 2009), HQ 544944 (May 26, 1992), HQ 543252 (Mar. 30, 1984).*

*[2] HQ 542701 (Apr. 28, 1982), HQ 543477 (May 1995).*

*[3] CBP states that if importers claim adjustments outside the reconciliation program, they will be expected to demonstrate at the time of entry that the price is at arm's length, as well as provide supporting information.*

## 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 4 September 2012.

| Currency unit | Value in euros (EUR) | Value in US dollars (USD) |
|---|---|---|
| Canadian Dollar (CAD) | 0.80596 | 1.01387 |
| Chinese Yuan Renminbi (CNY) | 0.12535 | 0.15769 |
| US Dollar (USD) | 0.79494 | 1.00000 |

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