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TRANSFER PRICING NEWS

ARGENTINA
The so-called "sixth method"
READ MORE 3

CHINA
Implementing GAAR
READ MORE 6

UNITED STATES
Transfer pricing audit roadmap
READ MORE 10

COUNTRY-BY-COUNTRY REPORTING – OECD GUIDANCE

On 6 February 2015, the OECD issued guidance on the implementation aspects of Country-by-Country (CbC) Reporting for tax, following up from its report in September describing a three-tiered (master file, local file and CbC Report) approach to transfer pricing documentation. This represents one of the most significant milestones in the OECD's Base Erosion and Profit Shifting (BEPS) initiative; the OECD/G20 and tax administrations see it as the single most important achievement of the international tax transparency agenda.

The key highlights are:

- **Timing**
  The first CbC Reports are required for fiscal years beginning on or after 1 January 2016.
- **Exemption for Smaller international groups**
  There is to be an exemption for groups with total revenues of less than EUR 750 million (but the appropriateness of this will be reviewed in 2020).
- **Other exemptions**
  There will be none. All industries will be included, as will investment funds and all 'non-corporate' entities.
- **Consistency of data disclosed**
  The OECD emphasized the importance of utilizing the standard CbC Reporting template.
- **Confidentiality**
  Information provided in the CbC Reports will not be available to the public and will only be exchanged between tax authorities through existing mechanisms under double tax conventions (or as enabled through the OECD's proposed multinational instrument).
- **Appropriate use**
  Jurisdictions are directed to use the CbC Report to assess high-level transfer pricing risk but may also use it to assess other BEPS-related risks.
- **Filing mechanisms**
  CbC Reports will be filed with the jurisdiction of the ultimate parent entity of a group within one year from the close of the fiscal year concerned. A requirement to file locally or to the next tier parent entity may be required if the ultimate parent jurisdiction does not require CbC Reporting or there is no adequate mechanism for the timely exchange of CbC Reports (or there is a failure to do so in practice).
- **Government-to-government exchange of information**
  There is to be an 'implementation package' to facilitate effective exchange of information, including by way of automatic exchange.

The primary purpose of CbC reporting is as a risk assessment tool for tax administrations. The OECD specifically recognise in their release of 6 February that the need for countries "for more effective dispute resolution may increase as a result of the enhanced risk assessment capability following the adoption of a CbC Reporting requirement".

Businesses need to prepare themselves for the nature and level of tax authority scrutiny that will inevitably arise from CbC Reporting. Our approach and proprietorial CbC tools will enable you to efficiently and effectively identify, measure and manage your risk. Please contact your BDO advisor to discuss how we can help you manage that risk.

CONTENTS

INTRODUCTION

Transfer pricing is increasingly influencing significant changes in tax legislation around the world. This 16th issue of BDO's Transfer Pricing Newsletter focuses on recent developments in the field of transfer pricing in the USA, China, Singapore and Argentina.

An example of the changing transfer pricing landscape is the current situation in India, where transfer pricing has evolved substantially from its initial introduction in the Indian Income-Tax Law in 2001. BDO India's Transfer Pricing team has prepared an extensive summary to help readers to understand the key challenges and changing landscape of Transfer Pricing law in India, and to evaluate options to mitigate Transfer Pricing disputes. As the contents of this summary are too extensive to be covered by an article in TPN, the summary document can be read at http://bdo.in/pdf/Transfer_Pricing_PRISM_2014_A_BDO_INDIA_publication.pdf.

We are very pleased to bring you this 16th 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.

ARGENTINA

ARGENTINA AND THE SO-CALLED "SIXTH METHOD"

General concepts

Over the last ten years, international trade has shown a material growth globally, while states have gained greater control to safeguard the revenues they are entitled to collect. In this context, and under income tax laws, transfer pricing provisions have become a key element in examining the appropriate allocation of profits between jurisdictions, both by tax authorities and multinational enterprises.

All this emphasises the need to take great care determining and documenting market values considered reasonable in accordance with transfer pricing standards. However, multinational enterprises with a high volume of transactions with related parties have seen increased levels of confrontation and disputes with tax authorities regarding these issues.

In spite of the fact that the Organisation for Economic Cooperation and Development (OECD) and some countries are working to standardise transfer pricing rules globally, these regulations are still subject to interpretations that are not fully consistent between different jurisdictions, and this involves a material risk for multinational enterprises so far as transfer pricing, potential double taxation, interest and penalties are concerned.

Transfer pricing regulations in Argentina

In Argentina, tax regulations applying to transfer pricing are included under the income tax law (sections 8, 14, 15, 15.1, 129 and 130), its regulatory decrees, and general resolutions (AFIP) 1122/2001, and their amending and supplementary provisions. Furthermore, the OECD transfer pricing guidelines for multinational enterprises and tax administrations have to be taken into account.

All the above-noted regulations are based on the arm's length principle, under which transactions with related parties must be agreed based on the prices or considerations that unrelated parties would have used in comparable transactions. However, it must be noted that certain local regulations on transfer pricing include some rules that may not be consistent with the OECD guidelines. For instance, under the Argentine law, and in specific situations, a special method for transactions involving commodities, commonly known as the "sixth method" should be applied.

The so-called "sixth method" in Argentina

In order to analyse this issue, we should first measure the importance of commodities for our country. According to data from the National Statistics Board (INDEC), around 65% of the country's exports consist of sales of commodities.

It should further be mentioned that a significant proportion of these activities is carried out by multinational enterprises, and therefore the proper allocation of taxable bases in the different jurisdictions is a relevant factor for the tax authorities involved. This explains why transactions involving commodities have recently featured amongst the main issues discussed.

Transactions involving commodities are usually assessed by applying the CUP (comparable uncontrolled price) method, with internal or external comparables, depending on the available data.

However, amendment No. 25,784 to the income tax law, in force as from 22 October 2003, provides that in import or export transactions for which a public international price can be quoted in transparent markets, stock exchanges or similar entities, those prices should be applied to determine the Argentine-source net income. In addition, pursuant to that amendment, the so-called "sixth method" was introduced, which applies where:

- Exports are made to related parties;
- The exports involve cereals, oil seeds, and other products of the region, hydrocarbons and their derivatives, and in general, goods with publicly quoted prices in transparent markets; and
- Participators include an international intermediary, other than the actual recipient of the goods.

The best method of determining the export income will be **the quoted value of the goods in the transparent market on the day on which they are loaded**, irrespective of the means of transport used, and **not taking into account the price which would have been agreed with the international intermediary**. However, if the price agreed with the international intermediary was higher than the quoted price in force at the stated date, the former price would apply in relation to the transaction.

The law further provides that this method will not apply if the taxpayer duly proves that the foreign intermediary meets all the following requirements:

- It has an actual presence in the territory of residence, i.e. business premises there, from where its business is conducted, and meets the legal requirements regarding incorporation and registration as well as the filing of financial statements. Likewise, the assets, risks and functions undertaken by the international intermediary must be in conformity with the volumes of traded transactions;
- Its main activity must not involve passive income or any involvement in trading goods from or to the Republic of Argentina or with other members of the economically related group; and
- Its international trade transactions with other members of the same economic group cannot exceed 30% of the annual aggregate transactions agreed by the foreign intermediary.

Case law related to commodities in Argentina

Taking into account the specific Argentine legislation, it should be mentioned that there are several administrative and legal cases relating to commodities, which up to the present, can be divided into: (i) case law relating to agricultural commodities prior to the enforcement of the so-called "sixth method"; (ii) case law relating to energy commodities; and (iii) case law relating tax evasion under the criminal tax law.

(i) Agricultural commodities prior to the so-called "sixth method"

Court decisions relating to the trading of agricultural commodities, prior to the enforcement of the so-called "sixth method", include 1) Alfred C. Toepfer Int. S.A.; 2) Nidera S.A.; and 3) Oleaginosa Moreno S.A. In almost all the cases, the main activity in which the companies are engaged is related to the export of commodities (i.e. grains, cereals and oilseeds) of Argentine origin. These companies maintain that the commodity's trading price is the market value at the time of the transaction or of agreeing the transactions. On the other hand, the AFIP DGI controls and independently determines the income subject to income tax for the fiscal period 1999 and/or 2000, depending on the case. In general, companies develop their activities through foreign intermediaries, and explain the reasons for their need and method of operation.

In some cases, it is held that the operations are performed in compliance with the terms of the GAFTA (Grain and Feed Trade Association), which is a previously agreed sample contract, which the tax authority does not acknowledge. In this regard, taxpayers state that the tax authority arbitrarily creates a fiction, which entails determining that the price fluctuation risk will only pass to the foreign purchaser when the goods are shipped and not when the agreement is made. In any event, if the agreed price is higher than the market price at the time of shipment, the collecting entity withholds the greater amount, without any legal basis applying to the years mentioned above.

It is further pointed out that the lack of an actual date does not hinder the use of agreements, since these were made in accordance with customs and usage. In addition, at that time the agreements did not have to comply with specific requirements or with any other registration procedures. Taxpayers can also request that symmetrical adjustments be acknowledged; in other words, that positive and negative adjustments be considered if the prices taken into account are those of the Secretariat of Agriculture, Livestock, Fisheries and Food (SAGPyA) at the date of shipment.

On the other hand, the tax authority denies the retrospective application of law No. 25,784 (use of the "sixth method") and mentions that the timing aspect is validated in the value reported by the SAGPyA at the time of shipment, since it understands that the export of assets was legally established at that time. The tax authority further states that agreements have no actual date and therefore this renders them unenforceable for third parties - and even if they were, they would not reflect the market value at the time of completing the shipment.

It is important to highlight that the cases had different outcomes, and there is still no judgment from the Supreme Court of Justice regarding these disputes. Some cases were settled in favour of the taxpayers and others in the favour of the tax authorities. In all cases, the key element was the evidence submitted by taxpayers to defend their positions.

(ii) Energy commodities

There are no records in relation to disputes regarding energy commodities. The only case that could be analysed in this field is YPF S.A. in the Argentine Tax Court. The main activity of the company was the extraction, exploration and distillation of hydrocarbons. In that scenario, the AFIP DGI controls and independently determines income tax for the fiscal period 2000, including transfer pricing concepts. The transactions under analysis included exports of commodities (diesel gas, butane and propane) to related companies and traders.

The arguments put forward by the taxpayer include the following:

- To apply the CUP, a maximum level of accuracy is required for comparable purposes (identical transactions or making adjustments).
- An explanation of the price setting policy, which the tax authority does not acknowledge. These products have prices in transparent international markets or stock exchanges.
- Pursuant to the agreements, in all the cases the price is determined using market data (i.e. Platt`s Oilgram US Marketscan) and taking into account an adjustment to this positive or negative value called "premium". It was stated that this price-setting policy is used both in transactions with related and independent parties.
- Reference was further made to the issue of the transaction date, and differences were established between the date of agreement, the shipment date and date of the bill of lading.
- It was mentioned that the tax authority used in its first resolution an annual interquartile range and then used an interquartile range made up of selected samples.
- It was claimed that the application of the interquartile range, pursuant to the provisions of general resolution (AFIP) 1122/2001, for the year 2000 implies re-opening a closed year, while the income tax law and the regulatory decree in force at that time should be applied.
- It was pointed out that the transactional net margin method (TNMM) additionally ratifies the arm's length situation in intercompany transactions. The income of YPF S.A. was not below the interquartile range.

However, the Argentine Tax Court judges did not analyse the elements of the case to arrive at their decision. They simply mentioned that they would firstly consider whether the provisions in force for 2000 should apply retrospectively or not. In this regard, they noted that general resolution (AFIP) 1122/2001 was issued in 10/2001, after the fiscal period under consideration. Therefore, applying it retrospectively would imply ignoring the principle of legality and infringing legal certainty. The tax authority could never validly retrospectively apply the interquartile range specified by that general resolution. The median and interquartile ranges are only legally incorporated with the enactment of decree order 916/2004. The fact that the taxpayer elected to apply the interquartile range for that period was the company's choice in carrying out a thorough analysis, but under no circumstances does it imply that this mechanism is mandatory. The case was settled based on the above.

Several considerations follow from the analysis of this case:

- Firstly, once again the substance of the case was not analysed. This means that the issue was settled, but with no clarification regarding the mechanism and proper application of the CUP (i.e. no thorough analysis was made of the trading of commodities with and without premium, the offsetting of prices above and below the range, the characteristics of the publicly quoted prices, etc.)
- Secondly, the resolution enforces the principle of legality and the non-retrospective nature of tax laws.
- Finally, it is established that the interquartile range and the adjustment to the median are deemed valid from the enactment of decree order 916/2004 published by the middle of 2004.

(iii) Commodities and tax evasion pursuant to the criminal law

The Federal Court of Appeals in criminal economic matters delivered its verdict in the Cargill S.A.C.E.I. case. The company's main activity was the processing, marketing and export of grains, oils, flours and other commodities. The destination of its sales was overseas, and exports accounted for 90% of its total revenues. The transactions challenged by the tax authority were certain exports made through its Uruguayan branch. The dispute arose from the use of the agreement date or the shipment date.

The defendants had been charged with the offence of tax evasion for over ARS 1 million, but the judges hearing the appeal dismissed the charges, as no malicious intent was proven.

The taxpayer maintained that the prices were agreed verbally (by telephone) or alternatively by mail. In addition, it stated that the prices were determined based on supply and demand factors on the day of performing the transaction (as opposed to the shipment date). In most cases, the prices agreed were higher than the ones quoted at the time of shipment, and in weighting total exports, the tax to be paid at the shipment date would have been lower. All this was stated and proved by expert evidence.

The court noted that the agreements were not recorded in certified copies including an actual date. At the same time, it indicated that no offsetting was allowed for losses and profits, and that the transfer pricing verification must be done individually and not globally. Finally, the Federal Court of Appeals with jurisdiction over Criminal Economic Matters ruled that "irrespective of right or wrong considerations having been made by the judge, the calculation of the tax liability is affected, but the charge of having committed a wilful offence is rendered void. It was therefore clearly proven that the use of the plaintiff's criteria would have resulted in the tax liability being lower than that declared. It is obviously unlikely, therefore, to render those representations misleading. The consistent application of the criteria stated by the defendants, whether or not correct or in accordance with tax law or regulations, proves that there was no malicious intent in the case".

Final considerations

In case law relating to commodities, the existence or non-existence of an actual date in the agreements therefore becomes a significant issue. Considering the importance of commodities transactions for Argentina, it would be very useful if the provisions applicable to these transactions did not give rise to concerns or vacuums, to enable companies to understand how they must pay taxes and to provide the tax authorities with an easier way to review them. Therefore, more certainty would be offered to taxpayers, the risk of potential tax contingencies would be eliminated, and the level of disputes over these issues would be reduced.

Moreover, from reading all the case law rulings, it is noticeable that proof becomes a substantial element in all the cases. The onus is on the tax authority to reverse the burden of proof given by taxpayers and, for most judges, mere rhetoric is not enough. It can also be noticed that there are many cases in which the issue under discussion is similar, but the judges ruled differently, all based on the proofs submitted during the process.

Finally, it should be highlighted that Argentina was the first jurisdiction to develop the so-called "sixth method" by the year 2003. Following this, many Latin American countries, as well as some emerging countries that do not belong geographically to the region, have begun to consider this type of ruling, with some amendments or adjustments. At the same time, some OECD and United Nations publications show that these organisations have begun to take these issues into account. In fact, in December 2014 the OECD issued a discussion draft on the transfer pricing aspects of cross-border commodity transactions, proposing changes to the Transfer Pricing Guidelines. As usual, this discussion draft is published for comment by interested parties.

Therefore, we need to follow all these issues closely and take care with the treatment of transactions involving commodities.

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CHINA

IMPLEMENTING GAAR

On 3 July 2014, the State Administration of Taxation (SAT) published a discussion draft on Administrative Measures for General Anti Avoidance Rule (GAAR) (Draft Measures) for public comment. The public consultation closed on 1 August 2014.

The GAAR was introduced in the Corporate Income Tax (CIT) Law with effect from 1 January 2008, and some general guidelines were provided in the Implementation Measures on Special Tax Adjustments (Trial) issued by the SAT in early 2009 (Circular 2). Chinese tax authorities have been paying a lot of attention to tax avoidance and treaty shopping, especially on non-residents' business activities. In addition to the CIT Law and Circular 2, a series of steps, i.e. promulgations of various influential and controversial regulations (such as Guoshuihan [2009] No. 601 and Guoshuihan [2009] No. 698), increased information exchange and a growing number of tax audits have been put in place to show China's view on aggressive tax planning.

The Draft Measures serve as a procedural guideline on the application of GAAR, showing that the SAT has put a lot of effort into introducing international practices to combat abusive and aggressive tax planning. The following sections summarise the details in the Draft Report, as well as its impact from our point of view

Scope

Except for two scenarios, special measures are designed for tax authorities to apply a special tax adjustment to any tax avoidance arrangements which enterprises use to obtain tax benefits without a reasonable commercial purpose. The two exemptions are for:

- Arrangements between Chinese Tax Residents not involved in cross-border transactions or payments; and
- Illegal activities relating to avoidance of tax payments, avoidance of recovery of evaded taxes, tax fraud, resistance of paying tax and the issue of false invoices.

The applicable GAAR administrative measures on non-residents' indirect transfer of Chinese equity will be developed by the SAT on a separate basis.

Key principles provided by the Draft Measures

The following important principles in the application of a GAAR assessment are set out in the Draft Measures:

- A tax avoidance scheme that is intended to obtain a tax benefit and without reasonable commercial purpose is subject to GAAR adjustment.
- The main characteristics of a "tax avoidance scheme" are:
  - The sole or main purpose, or one of the main purpose of the tax arrangement is to obtain a tax benefit; and
  - The form of scheme is permitted in accordance with the tax rules, but the form is not consistent with its commercial substance.
- The definitions of certain crucial concepts such as "tax benefit".
- Tax authorities should assess GAAR cases based on both a purpose test and a substance test.
- Adjustment methods upon invoking GAAR.
- GAAR should be the last resort, i.e. it should not be invoked until the specific anti-avoidance rules such as transfer pricing and thin-capitalisation rules or tax treaty provisions for beneficial owners are exhausted.

Procedures for Chinese tax authorities when dealing with a GAAR case

The Draft Measures provide a set of comprehensive procedures for the life cycle of GAAR implementation, which can be identified into the following steps:

1) In-charge tax office to select potential cases
2) In-charge tax office to submit a case registration application to higher-level tax office
3) Higher-level tax office to submit the case to the SAT for approval
4) In-charge tax office to issue a formal tax investigation notice to launch a GAAR investigation
5) In-charge tax office to issue a tax information request letter to tax advisers, related parties, or other relevant parties or to the enterprise, for the provision of required information within 60 days from the receipt of the notice
6) In-charge tax office to review information and form an initial conclusion
7) Higher-level tax office to review the initial conclusion and submit to the SAT for their approval
8) Enterprises to apply for appeal systems regarding the Preliminary Conclusion Notice, as well as the Final Conclusion Notice.

Impact on taxpayers

It is a breakthrough for the Draft Measures to clarify how the Chinese tax authorities would apply GAAR to a tax avoidance scheme from a procedural perspective. With the increased standardisation and transparency of these procedures, we believe taxpayers can have a better sense of how the Chinese tax authorities would use this "last resort" to counter the avoidance of tax. However, the Draft Measures do not provide a timeline for the tax authorities to respond to taxpayers or a requirement for tax authorities to give taxpayers certainty on whether or not a case is subject to GAAR.

Notwithstanding the clarification of certain GAAR principles in the Draft Measures, GAAR has a broad spectrum, resulting in it possibly being interpreted in a more extensive manner. Under the current version, GAAR would be triggered if the sole or main purpose or one of the main purposes of a tax arrangement is to obtain a tax benefit. This appears to have broadened the scope for application of GAAR, as the Detailed Implementation Rules of the CIT Law only refer to the 'main purpose' and not 'one of the main purposes'. It may be easy for taxpayers to fall within the scope unless they can prove that there was no intention at all of gaining a tax benefit.

The Draft Measures indicate that there would be a separate rule for offshore indirect equity transfers which could be subject to GAAR. We understand that GAAR implementation on offshore indirect equity transfers should still follow the basic procedures provided in the Draft Measures. The separate rule should set out additional guidelines specifically for handling offshore indirect equity transfer cases. We understand that many multinational companies are concerned about when the subsequent rules to Circular 698 will be released. We believe that it may not be too long after the GAAR Measures are finalised and promulgated.

Our view

Since publication of the OECD Base Erosion and Profit Shifting (BEPS) report, tax authorities throughout the world have been strengthening their anti-avoidance forces. The BEPS action plan may contain three tiers of actions: Strengthening multiparty cooperation, reviewing/(re)negotiating bilateral tax treaties, and amending domestic tax laws. Although China is not a member country of OECD, it is natural for China to follow international practice to secure its tax sovereignty.

The Draft Measures would be just one step, and the first step in China's efforts to amend domestic laws to enhance the Chinese tax authorities' legal basis to tackle tax avoidance arrangements. Other on-going developments may include amendments to the Tax Collection and Administrative Law, Individual Income Tax Law, and the supplementary rules for Circular 69. We will monitor developments and update you on the status of China's anti-avoidance campaign.

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SINGAPORE

PUBLIC CONSULTATION PAPER ISSUED FOR TRANSFER PRICING DOCUMENTATION

On 1 September 2014, the Inland Revenue Authority of Singapore (IRAS) issued a public consultation paper on transfer pricing documentation ("the Paper"). The Paper paves the way for paradigm shift relating to transfer pricing documentation rules in Singapore, as it seeks to update and tighten the existing documentation requirements of the 2006 Circular[1]. The objective of the Paper is to provide more comprehensive guidance on transfer pricing documentation requirements in Singapore.

Overall, the Paper is centred on the objectives of preparing transfer pricing documentation, emphasis on preparing a contemporaneous transfer pricing documentation, the types and extent of documentation, and other compliance matters. One of the most important parts of the Paper relates to safe harbour rules. Under the safe harbour rules, taxpayers are exempted from preparing transfer pricing documentation in certain situations. The Paper also provides a comprehensive list of contents for inclusion in the documentation which serves as a guidance tool for taxpayers, as IRAS notes that "taxpayers are not expected to incur compliance costs which are disproportionate to the amount of tax revenue at risk or complexity of the transactions".

The issue of the Paper around the time the Organisation for Economic Co-operation and Development (OECD) issued its updated documentation guidelines[2] on 16 September 2014 signals the IRAS's endorsement of OECD's views[3] on maintaining robust contemporaneous transfer pricing documentation to readily demonstrate that the transfer prices are indeed determined in accordance with the arm's length principle. Companies will now have to consider the impact of the revised transfer pricing documentation requirements, as the new guidance will facilitate tax authorities' assessment of taxpayers' transfer pricing risks and identification of cases for audit.

[1] *IRAS Circular on "Transfer Pricing Guidelines" issued on 23 February 2006*

[2] *Action 13: Guidance on Transfer Pricing Documentation and Country-by-Country Reporting*

[3] *Singapore is not a member of the OECD*

The key changes discussed in the Paper are noted below:

Two-tiered approach for transfer pricing documentation

Taxpayers are expected to provide documentation of their group and the specific companies involved in the related party transactions. With this objective, the IRAS requires taxpayers to organise their transfer pricing documentation into:

- **Group level documentation**
  This is expected to provide a good overview of the group's businesses, and should include details on the group's global business, organisation structure, the nature of the global business operations and overall transfer pricing policies. In addition, information on important drivers of business profit, including a list of intangibles and the related parties which legally own them is now required. Charts showing supply chains of products and services, and a functional analysis describing contributions to value creation by each related party within the group, i.e. a functional analysis including intangibles used and/or contributed and the group's transfer pricing policies relating to all types of transactions between related parties within the group, are now included.

- **Entity level documentation**
  This contains much of the similar information that was required previously, such as the taxpayer's business operations and specific details of transactions with its related parties. Amongst the new additional information required is information relating to the management structure of the Singapore taxpayer, including a description of the individuals to whom the Singapore management reports and the countries in which such individuals maintain their principal offices, an organisational chart of the taxpayer showing the number of employees in each department, and segmented financial accounts with respect to the transactions, if any.

With these new additions, the level of documentation required will substantially differ from the previous 2006 version, thereby providing a greater level of detail and a good overview to tax authorities in identifying cases for audits. The Paper therefore provides examples of cases where transfer pricing risks may be significant. These examples include the use of transfer pricing strategies to shift profits to more favourable tax jurisdiction, cross-border large value transactions, transactions with related parties in low tax jurisdictions, operating results not in line with industry norms, or transactions involving research and development or marketing activities which could lead to development or enhancement of intangibles.

Contemporaneous transfer pricing documentation

A critical shift from the 2006 documentation guidelines is the requirement to prepare and maintain contemporaneous transfer pricing documentation to substantiate taxpayers' transfer pricing. Contemporaneous transfer pricing documentation is defined as documentation prepared prior to or at the time of undertaking the transaction, including up to the time of preparing the relevant tax returns.

Exemption from transfer pricing documentation

IRAS does not require taxpayers to prepare transfer pricing documentation in the following two situations:

- Where they apply the Singapore safe harbour mark-up of 5% for routine services; or
- Where small and medium enterprises (SMEs) related party transactions are local transactions and subject to the same Singapore income tax rate. A SME is defined as one with annual sales turnover of not more than SGD 100 million, or which employs not more than 200 people.

Compliance matters

Taxpayers are not required to submit transfer pricing documentation with their tax returns, and it is only upon request from IRAS that the documentation should be submitted. However, no specific timeframe is provided in the Paper regarding the number of days or month by when the taxpayer should submit once the documentation is requested by IRAS.

Conclusion

The Paper with revised documentation guidelines indeed places an onerous responsibility on taxpayers. It is therefore imperative that taxpayers take a "second look" at their existing status of related party documentation and take necessary steps for updating or amending that document with a view to defending their transfer prices in the event of an IRAS query. Although the Paper currently serves as a guidance tool, as it is in the form a guideline, it remains to be seen whether the IRAS will retain it as a guideline or legislate it in the statute, thereby making transfer pricing documentation a mandatory requirement in Singapore.

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UNITED STATES

TRANSFER PRICING AUDIT ROADMAP

Introduction

On 14 February 2014, the Internal Revenue IRS (IRS) released the Transfer Pricing Audit Roadmap (the "Roadmap"), which outlines the three phases of a transfer pricing examination: planning, execution and resolution. The Roadmap highlights that, from an IRS perspective, transfer pricing audit cases are won and lost on the facts. It is a toolkit designed by the IRS to:

- Assist its agents in carrying out audits;
- Attempt to create more structure regarding audits; and
- Provide guidance to perform risk assessment of transfer pricing issues.

The Roadmap is intended for use by international examiners involved in 24-month audits. It states that transfer pricing specialists should be involved before the audit begins. The Roadmap is a useful tool for taxpayers, as it provides a timeline for the audit, as well as the type of information and documents a taxpayer is expected to provide. Most importantly, the Roadmap focuses on developing facts to determine whether a transfer pricing position can be sustained upon examination.

The overall reaction from taxpayers and practitioners has generally been favourable. Although more work is required, the Roadmap is seen as a useful tool to help the audit process progress more smoothly, as well as expand taxpayers' understanding of the IRS's transfer pricing concerns.

Discussion

The ultimate goal of a transfer pricing audit is to determine whether a taxpayer's financial results are reasonable, given its value chain and competitive position within its industry. The Roadmap organises the progression of a transfer pricing audit into the following three phases: planning, execution, and resolution.

1) **Planning Phase**

The Planning Phase spans between three and six months. During this time, the IRS reviews the taxpayer's business, effective tax rate, and income sourcing, to determine whether the taxpayer has shifted profits through transfer pricing. If the IRS determines that profitability is reasonable, it may conclude that further examination is unnecessary. If circumstances are not reasonable, the IRS is likely to proceed to the Execution Phase (further discussed below).

In the Planning Phase, the IRS will issue an Information Documentation Request (IDR), along with a request for a transfer pricing orientation meeting. An initial risk analysis, examination plan and key milestones are also established in this phase. The IRS is likely to request documents including, but not limited to, a comprehensive transfer pricing documentation study; accounting data such as segmented profit and loss statements; intercompany agreements or contracts; Forms 10-K and 5471/5472. The IRS may review company websites and any other relevant material for consistency. In addition, the IRS will conduct interviews with the taxpayer, initiate site visits, or prepare its own comparable searches and analyses. The IRS may also coordinate with the Advance Pricing and Mutual Agreement team and inform treaty countries of the audit.

At the conclusion of the planning phase, the audit team should have a clear understanding of the taxpayer's legal organisational structure, as well as the functional and risk profiles of the entities involved in the material intercompany transactions. These facts can either provide a clear rationale for entering into certain intercompany transactions, or signal to the audit team that a transaction warrants further substantiation and development, especially if the intercompany transaction is associated with the transfer of an income stream.

2) **Execution Phase**

The Execution Phase, which includes fact finding and issue development, overlaps with the end of the Planning Phase. This phase spans over months 3 through 18 of the audit. The audit will enter the Execution Phase if the IRS determines that there may be issues with profit shifting and improper use of transfer pricing. In the Execution Phase, the IRS will develop its own transfer pricing study, additional IDRs, and conduct additional functional interviews. Functional interviews are intended to identify the activities that are economically significant to the taxpayer's intercompany transactions, as they have material impact on the price charged and profits earned as a result of a transaction. The IRS will also review and critique the transfer pricing documentation report provided by the taxpayer, and challenge the method(s) and assumptions employed. Transfer pricing adjustments or penalties may be considered.

3) **Resolution Phase**

The Resolution Phase is the final phase of an audit. During this phase, the IRS will prepare its argument against the taxpayer's transfer pricing position. In order to close the audit with the best possible outcome, the taxpayer should consider coming to an agreement, or resolution, with the IRS.

The diagram below shows the three phases of the quality examination process[4].

[4] *Note:*
The Transfer Pricing Audit Roadmap may be accessed on the IRS web site at http://www.irs.gov/pub/irs-utl/FinalTrfPrcRoadMap.pdf. The Roadmap includes many links to other documents and audit tools used by the audit team.

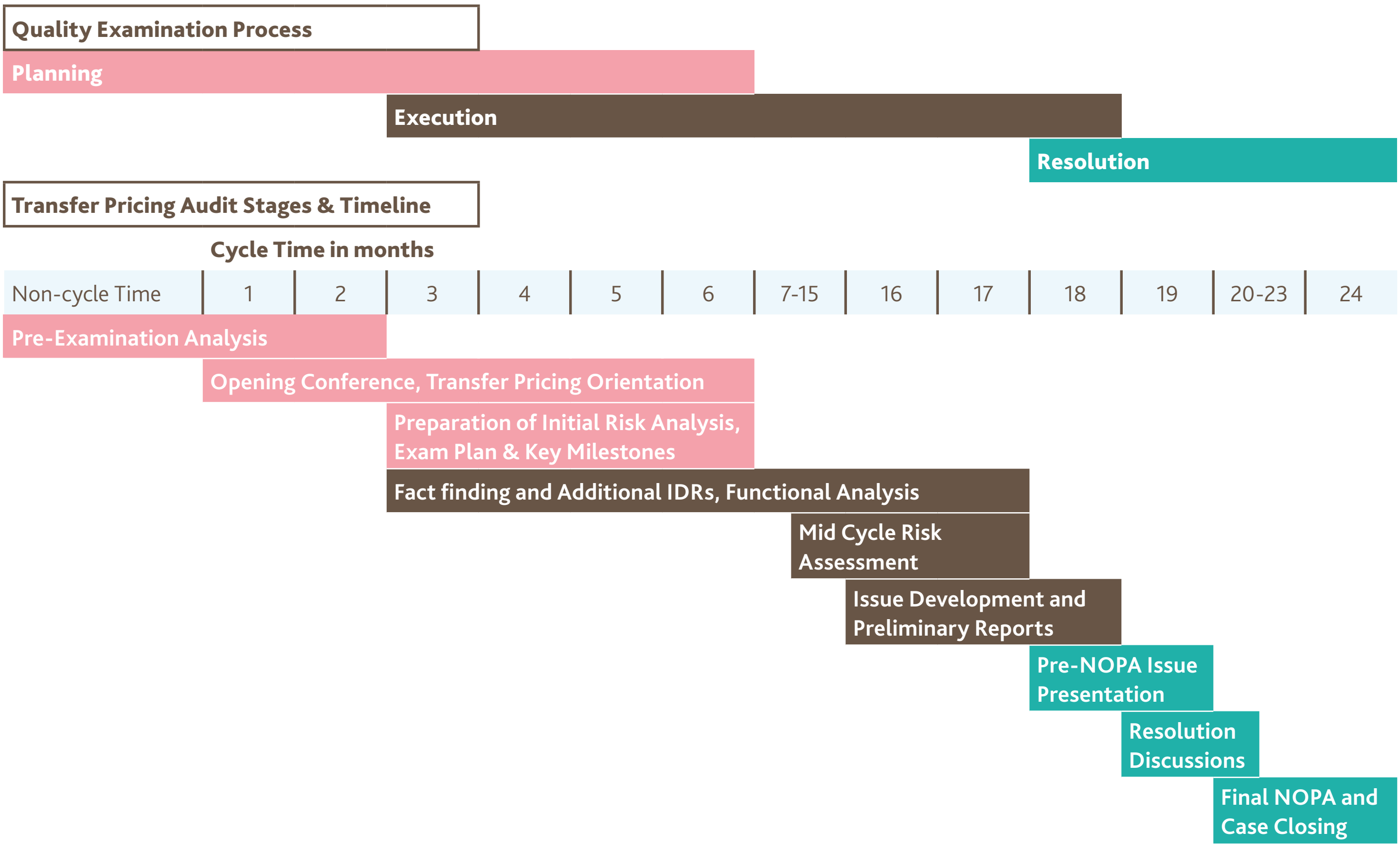

Figure 1: Quality Examination Process

Conclusion

The Roadmap provides valuable insights into the IRS's transfer pricing examination process, as it explains the kinds of questions and information taxpayers should expect to provide and discuss. Taxpayers should use the Roadmap as a guide to prepare the information and documentation needed to withstand a detailed transfer pricing audit.

Viewing the Roadmap from the context of a taxpayer, the main goal is to conclude the transfer pricing examination in the Planning Phase. This means presenting the IRS with information and transfer pricing documentation that is sufficient, non-contradictory, and that effectively explains the taxpayer's transfer pricing positions globally. In addition to the information provided, the orientation meeting conducted in the Planning Phase provides a great opportunity for the taxpayer to articulate the reasonableness of its positions. It is clear from the Roadmap that once the Execution Phase commences, a transfer pricing adjustment is imminent. However, since transfer pricing resources are limited at the IRS, it will likely only be able to move cases into the Execution Phase that if feels has a solid case for a transfer pricing adjustment.

To avoid the Execution Phase, planning and preparation are essential. In addition to assisting taxpayers in developing their transfer pricing documentation, BDO can perform a pre-audit assessment of whether transfer pricing policies are adequate and supportable. In the face of an audit, BDO can help prepare the response to the IRS's inquiries and develop a working hypothesis that leads the IRS to conclude that further examination is not necessary.

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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 19 January 2015.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Argentine Peso (ARS)	0.10032	0.11613
Singapore Dollar (SGD)	0.65062	0.75312

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