Tax Newsletter

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CHANGES IN THE WORLD OF INTERNATIONAL TRANSFER PRICING

FOCUS ON COUNTRY-BY-COUNTRY REPORTING ("CBCR")

The most important trend in the world of international transfer pricing is that more and more countries implement the recommendations set out in the BEPS Action Plan. This means that an increasing number of states commit to actually eliminating tax structures with no real substance, increasing the effectiveness of the international exchange of information, and thus making it harder to evade taxes. One of the efficient means of this may be the introduction of Country-by-Country Reporting. In addition, new phenomena can be experienced in the judicial practice related to transfer pricing as well.

The final recommendations of the action plan encompassing 15 areas were published by the OECD in 2015. The guidelines on handling commodity transactions, the profit split method, the profit attributable to permanent establishments, and financial transactions, however, are still being elaborated. From among the points already finalised, those most closely related to transfer pricing are actions 8 to 10, as well as action 13.

Actions 8 to 10 put into the focus the value creation processes of multinational groups, the functions related to intangibles, and the risk analysis strategies of company groups. Further, they provide guidance on cost contribution agreements and low value-adding intragroup services.

Action 13 contains revised guidance on transfer pricing documentation, by recommending the introduction of a three-tiered documentation requirement. Two tiers are the already known main document (‘‘Master File’’) and the country-specific record (‘‘Local File’’), which taxpayers have to prepare with new, extended data content.

Appearing as a new, third tier is the ‘‘Country by country report’’ (CbCR), which provides information on the financial and taxation situation of the whole group, as well as the activities performed, in a breakdown by country. This obligation applies to multinational groups with a consolidated revenue exceeding €750 million. Although fundamentally it is the ultimate parent entity that is required to file the CbCR, other group members may also have filing obligations in their own country, if:

- there is no CbCR regulation in the country of the ultimate parent company; or
- the country of the ultimate parent company has no information exchange agreement that would extend to the CbCR; or
- despite the automatic information exchange agreement, there is a ‘‘systemic failure’’ due to which the exchange of information between tax administration is not possible.

Further, in case certain conditions are satisfied, the parent entity may appoint another group member as a surrogate parent entity to satisfy the reporting obligation on behalf of the entire group. It should be underlined that the examination of the abovementioned conditions is necessary between the countries of all group members and the ultimate parent entity (or the surrogate parent entity). The individual countries may also impose additional requirements beyond the recommendations set out by the OECD. Even though it is not related to Country-by-Country Reporting, an excellent example is the case of the United Kingdom where the publication of the tax strategy is required for multinational groups exceeding certain threshold values.

The exchange of the information to be shared in the Country-by-Country Report may occur subject to the terms of double tax conventions or a Multilateral Competent Authority Agreement. Further, by adopting Directive 2016/881/EU, the European Union made reporting and the automatic exchange of information mandatory for all Member States.

In compliance with the Directive, Hungary has also introduced relevant legislation. Hungarian parent entities and surrogate parent entities will first have such obligations for the 2016 tax year, with 31 March 2018 as the due date. The initial year of mandatory reporting for non-parent entities will be 2017, with a 12-month due date. In addition, the new provisions also impose an administrative obligation in the framework of which the enterprises concerned need to notify whether they are required to file a CbCR, and if so, in what status.

In addition to the changes in the international transfer pricing regulations as well as those of individual countries, some new trends can also be observed in the judicial practice.

Somewhat surprisingly, for example, the US Tax Court has ruled in favour of Amazon in the lawsuit with the IRS in connection with the transfer of intangible assets to Luxembourg. The most important lesson from the ruling is that the court found the application of the previously preferred discounted cash-flow methodology unfounded with respect to the valuation of the intangible assets.

By contrast, the Australian subsidiary of the Chevron oil group lost a court appeal against a $260 million tax bill. The Australian Federal Court found that Chevron used an internal financing structure to shift profits from its Australian to its American subsidiary, applying an unreasonably high (9%) interest rate while the creditor American subsidiary borrowed the amount from the market at the rate of 1.2%.

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