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WTS Transfer Pricing Newsletter

Editorial

Dear Reader,

It is our pleasure to present to you the third edition of our WTS Global Transfer Pricing Newsletter 2022.

In this latest edition of the WTS Transfer Pricing Newsletter, our colleagues from 13 countries provided an update on recently introduced legislations and cases.

The **Argentine** Tax Court has recently ruled on an interesting Transfer Pricing case, concerning the timing of benchmarking a transfer of goods. Further details about this case can be found in the article.

According to the **Austrian** contribution regarding intra-group financing in Austria, alongside the interest rate, a particular strong focus is placed by the tax authorities on whether the debt instrument might be re-qualified into "hidden equity". Thus, there should be documentation on the capital structure of the borrower, transparency of the loan agreement as well as the arm's length character of the terms and conditions.

Additionally, based on the recent decision of the **Austrian** Financial Court, liability commissions must be charged from the start of the loan agreement, reductions in the Transfer Pricing with respect to deliveries of goods must be credibly demonstrated and the arm's length interest must be charged for supplier credits.

In **Brazil**, the Superior Court of Justice has decided that, until further legislative measures are taken, the so-called PRL 60 method must be calculated in a specific way. Our article sheds light on the decision and elaborates on the main practical implications.

Our team in **Chile** presents a summary of the 2022 Tax Reform Act, which contains recommendations for updating the Transfer Pricing rules.

Our team in **France** elaborates on new rulings regarding local research tax credits paving the way for consistently deducing the local research tax credits and/or similar subsidies from any R&D cost-plus services provided by eligible French companies.

The **Indonesian** government introduced an additional three Transfer Pricing methods that provide further guidance on certain related party transactions. Our colleagues summarize the key aspects of this legislative development.

The **Italian** Tax Agency recently issued instructions with regard to the correct and practical use of the "arm's length range" for the application of Italian Transfer Pricing rules.

According to a recent court ruling in **Poland**, comparable studies prepared prior to the standards set in Polish Transfer Pricing regulations could limit the risk of tax controversy.

In **Saudi Arabia**, the relevant authorities have published their draft legislation on Transfer Pricing. The article highlights the main changes and innovations.

In recent years we have seen a growing "systematization" of the **Senegalese** Transfer Pricing audits. Our local colleagues explain this in more detail and provide initial recommendations for action.

Our colleagues in **Thailand** highlight the latest developments initiated by local tax authorities in connection with cash pooling arrangements. The article summarizes the main principles.

The article from our colleagues in **Ukraine** describes the fields of action related to Transfer Pricing despite the difficult circumstances caused by the war. In essence, this article elaborates on the fact that the Transfer Pricing world is not standing still during the war.

July 2022 saw the **United Kingdom** government publish a draft legislation with regard to Transfer Pricing documentation requirements with some significant changes. The article summarizes the main innovations.

Yours sincerely,

WTS Global Transfer Pricing Team

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Argentina

Argentine Tax Court ruling on *"Cargill"* Transfer Pricing Case

The Argentine Tax Court has recently ruled on the "Cargill" Transfer Pricing case, concerning the timing for benchmarking the exports of commodities (contract date vs. shipment date) as well as the tax consequences of using a foreign branch in the supply chain of products originating from Argentina.

Cargill Argentine subsidiary ("CSA") channelled 98% of its commodity exports through a Uruguayan branch ("CSU"). CSA invoiced the exports to CSU, but shipped the goods directly to the final clients (CSU customers). In fact, CSU performed the trader function for the products originating from Argentina, as a branch registered in Uruguay would not be exposed to foreign exchange restrictions, while it would consolidate its income with its head office in Argentina. The prices invoiced by CSU to its clients could be equal to, lower or higher than the price invoiced by CSA to CSU, since the trader would take the pricing risks—and hedge functions—from the date of purchase to CSA until the final sale to each customer.

The Argentine Revenue Service made two Transfer Pricing assessments to CSA, concerning fiscal periods 2000 to 2003: (i) a first one, increasing CSA export price to prevent CSU from experiencing a loss while on-selling such goods to either affiliated companies or deemed related parties (e.g. traders in low tax jurisdictions). For the Argentine Revenue Service, it was unreasonable that the trader, CSU, would be reselling at a loss, despite its risks and functions; and (ii) a second one comparing the value of the transactions carried out by CSU with related companies and traders, with the Argentine-listed "comparable uncontrolled price" published by the Argentine Agriculture Secretary on the date of shipment of the commodities, rather than on the export agreement date.

The Argentine Revenue Service dismissed both assessments. Concerning the first one, the Argentine Tax Court understood that the CSU profit and loss statement was always consolidated in the CSA's annual financial statements, so that the Transfer Pricing adjustment may not be made in the tranche between CSA and CSU. In fact, the Argentine Tax Court rejected the methodology used by the Argentine Revenue Service, since it would overlook the accounting consolidation without providing any sound reason for it. However, the Argentine Tax Court made no elaboration as to the need for the taxpayer's group to create a clear line between CSA Argentine-sourced income and its foreign source, which was collected by CSU.

Regarding the second assessment, related to the adequate timing for pricing commodity exports, the Argentine Tax Court stated that the "Sixth Method" was not in force during the fiscal periods scrutinized by the Argentine Revenue Service, so it was not legal to apply it on a retroactive basis. It should be noted that such a methodology was enacted ex post, namely by a change to the Argentine Income Tax Law in 2003, so as to allow the Argentine Revenue Service to benchmark internationally triangular transactions at the higher price on the export agreement date or the shipment date; whenever an unsubstantiated trader was placed in between. The Argentine Tax Court further noted that if the Argentine Revenue Service sustained that the benchmarking should have been made on the shipment date, it should have adjusted CSA export prices on such date in all cases, not only in those ones that experienced an upward pricing from the agreement date until shipment. In the Cargill case, the latter would only be a minority of the cases, according to the Argentine Tax Court. The taxpayer evidenced that if the Argentine Revenue Service would have benchmarked all CSA commodity exports on the shipment date, consistently, CSA would have experienced a higher loss, rather than a Transfer Pricing deficiency.

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The decision of the Argentine Tax Court in connection with the retroactive application of the "Sixth Method" was in line with the ruling of the Argentine Supreme Court in the *"Toepfer"* case (decision published on March 25, 2015). This ruling set the case law standards for the industry, which were later reproduced in other commodity exporters' cases such as the *"Nidera"* case (Supreme Court case, August 9, 2016).

Austria

Intra-Group Financing – Austrian Specifics

Hidden Equity
Intra-Group loan transactions are amongst those transactions that are most frequently discussed from a Transfer Pricing perspective. As an Austrian specificity, however, auditors regularly do not only focus on the arm's length character of the interest rate but place a particularly strong focus on whether the debt instrument might be re-qualified into "hidden equity" (leading to a loss of interest deductibility). Therefore, it should be clearly documented that unrelated parties would have granted debt financing under comparable circumstances.

The following indicate that no re-qualification into hidden equity should be made:

› **Capital structure of the borrower**
Whilst there are no statutory debt-to-equity ratios or thin-caps in Austria, this depends on the specifics of the company, such as industry standards, risk-assessment, start-up character, etc. An equity ratio of about 20% is regularly seen as appropriate.

› **Clarity and transparency of the loan agreement**
There should be a written agreement about the terms of conditions of the debt financing. Additionally, some documentation about the rating of the borrower should be available.

› **Arm's length character of the terms and conditions**
These include e.g. clear rules about the arm's length interest rate. If interest payments can be suspended, compound interest should be charged. Furthermore, a transparent repayment and interest payment plan should be drawn up based on the liquidity of the borrower.

These criteria should be assessed from an overall perspective at the time the loan is granted. For example, if a subsidiary is in a loss-making position for years and no turnaround is expected, the debt character of a loan might be challenged. A partial re-qualification is also possible.

Interest Rate

Concerning the interest rate, Austrian Transfer Pricing Guidelines are fully in line with the OECD Guidelines. The traditional comparable unrelated price method is generally seen as the preferred method. Factors such as repayment sum, maturity date, repayment dates, currency and securities need to be considered.

While practitioners regularly refer to the recent case law of the German Federal Court of Justice (May 18, 2021, I R 4/14; May 18, 2021, I R 62/14; June 09, 2021, I R 32/17), these have not been implemented in the Austrian Transfer Pricing Guidelines. Hence, there is still some uncertainty as to the extent to which bank loans are considered comparable to intra-group financing.

In view of the current inflation, it should also be considered if loan agreements are still up to date. In the case of long-term agreements with fixed interest rates, early repayments or re-negotiations might need to be applied.

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Austria

Decision of the Austrian Financial Court regarding Transfer Pricing

On June 2, 2022, the Austrian Financial Court ruled on the arm's length nature of a) the liability commission in context with a shareholder loan, b) the Transfer Price of products and c) the crediting of trade receivables (GZ. RV/7102082/2009).

The German parent company assumed a **guarantee** vis-à-vis the Austrian group company (complainant) with regard to a loan which the latter took out with a third party. A guarantee commission of 0.5% p.a. of the guarantee amount was charged. The Austrian Financial Court found that both the guarantee commission per se and the amount were at arm's length. Through the guarantee, the parent company provides a service in the years in which the loan agreements are applicable (principle of accrual accounting), so that the Austrian complainant must take the accrual expense into account (by means of a provision).

For the years 2003 and 2004, the complainant reduced the **Transfer Price for the goods** with 70% of the net sales prices of the German sister company to 66%. The Austrian Financial Court found that the complainant had not complied with the "increased obligation to cooperate", but nevertheless—in this specific case—considered the complainant's submissions regarding the arm's length nature of 66% of the net sales prices to be credible. The complainant submitted sales and contribution margin developments in this connection. Since the complainant's activity was assessed as an "extended workbench" and the price comparison method was not applicable due to a lack of comparability, the gross margin was moreover checked according to the cost-plus method.

No **interest** was paid on the outstanding trade receivables from the German sister company during the years in dispute, nor were any collection steps taken. The sister company achieved an interest advantage, so that the lost interest would have to be recognized by the complainant as increasing its income. Although the Austrian Financial Court considered a concession to be worthy of consideration due to the difficult market situation, it concluded that, in terms of an overall consideration, the non-interest payment was motivated by company law, so that there was a hidden distribution. With reference to the established case law of the Austrian Administrative Court, the asset allocation to the sister company is to be regarded as a distribution to the parent company with a simultaneous contribution to the sister company. Due to the lack of interest income, the person related to the parent company (sister company) obtained an advantage to the detriment of the complainant. The corresponding asset allocation is to be recognized off-balance sheet as a hidden distribution in the respective year.

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Brazil

Superior Court of Justice rules out illegal Methodology to calculate the PRL 60 Method

On October 4, 2022 the 1st panel of the Superior Court of Justice conclude the judgement of ARESP 511.736/SP, ruling out the calculation methodology of the 60% Profit Price Less Profit Method ("PRL 60") provided for in paragraph 11 of Article 12 of Normative Instruction SRF 243/2002 ("IN SRF 243/2002") (until Law 12715/2012 came into force).

The PRL 60 is a method to calculate the benchmark for imported goods. It was introduced into the Brazilian legal system by Law 9959/2000, which gave new wording to item II of Article 18 of Law 9430/1996, and was in effect until Law 12715/2012 came into force. The PRL 60 method involves the use of a fixed profit margin of sixty percent for the Brazilian legal entity for calculating the benchmark on imported goods destined for manufacturing, regardless of the economic background.

Through IN SRF 243/2002, the Brazilian Federal Revenue Service introduced a new benchmark calculation criterion for PRL 60 which differs to the benchmark calculation described in Law 9959/2000.

According to Law 9959/2000, the PRL 60 method involves the arithmetic weighted average of the resale price of goods, minus unconditional discounts, taxes levied on sales, commissions paid and the 60% profit margin, calculated on the net sales price minus the value added in the country. However, IN SRF 243/2002 included in the calculation (1st) the percentage of imported goods in the total cost of the goods manufactured; (2nd) the participation of imported goods in the sales price of the goods manufactured as determining factors for the profit margin and benchmark; and (3rd) excluding the added value in the country from the profit margin of 60%, previously calculated on the net sales price minus the added value in the country.

Considering that IN SRF 243/2002 substantially changed the PRL 60 calculation criteria provided for in Law 9959/2000 and led to higher Transfer Pricing adjustments in most cases, taxpayers began discussing the matter in administrative and judicial courts so as to dismiss the application of the PRL 60 method as provided for in IN SRF 243/2022 under the argument that IN SRF 243/2002 created a PRL 60 calculation formula without any legal basis.

The Administrative Court of Tax Appeals set out in precedent 115 that the calculation method for the PRL 60 provided for in IN SRF 243/2002 did not violate the provisions of Law 9959/2000.

With the consolidation of the Court of Tax Appeal's unfavourable understanding, taxpayers started appealing to the judicial courts to cancel tax assessment notices drawn up on the grounds of the PRL 60 method as provided for in IN SRF 243/2002.

After more than 20 years, the dispute arrived at the Superior Court of Justice, which ruled out the calculation of the PRL 60 method as provided for in IN SRF 243/2002 on the grounds that it violates Law 9959/2000. In the view of the Superior Court of Justice 1st panel, taxpayers should have observed the calculation provided for in Normative Instruction 32/2001 (which faithfully regulated the provisions of Law 9959/2000).

It is important to bear in mind that the 1st panel of the Superior Court of Justice issued this decision and that the 2nd panel has still to issue a ruling on the matter. Nevertheless, this decision brings a very much-needed breath of fresh air in the years-long dispute between taxpayers and tax authorities.

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Chile

2022 Tax Reform Bill Proposal to update Transfer Pricing Regulations in Chile

Last July[1], the Chilean government submitted to the Congress a proposed tax reform bill that aims to increase tax collections by 4.3% of GDP when fully implemented. This package includes "substantial and structural" changes to the corporate income tax regime that would affect businesses operating in the country, such as a reduction in the corporate rate, abolition of the partially integrated tax system and replacement with the separate taxation of companies and shareholders, changes to the Transfer Pricing rules and the introduction of a new royalty regime on the mining industry.

With regard to the Transfer Pricing rules, changes proposed are aimed to update the effective regulations and level these up with regional and OECD applications. These changes will improve the Chilean Revenue Service position and include:

a) **Business restructuring:** the Chilean Revenue Service powers would be enhanced with respect to challenges to Transfer Prices and values or establishing prices/values if they are not arm's length with regard to intercompany transactions and business restructurings. The reform bill would extend the Chilean Revenue Service powers in cases where agreements, contracts, etc. are terminated or substantially modified (substance over the form). Reorganizations that comply with the arm's length principle would not be subject to Article 41E of the Chilean Income Tax Law (Transfer Pricing principles) or Article 64 of the Chilean Tax Code (local restructuring and valuation rules).

b) **Transfer Pricing adjustments:** under the existing rules, the point of the interquartile range used to calculate a Transfer Pricing adjustment is not specifically set, although, in practice, the Chilean Revenue Service uses the second quartile (median value). Under the tax reform bill:

- If a taxpayer accepts the Transfer Pricing analysis conducted by the Chilean Revenue Service authorities and amends its Transfer Pricing filing (i.e., F1907, F1951 or F1950), the adjustment would be made using some point within the interquartile range; and

1 On 4 October 2022, the Chilean Executive Power submitted modifications (Modifications Bill) to the tax reform bill presented to Congress on 8 July 2022; but they did not affect the original transfer pricing chapter proposals.

- If the taxpayer does not accept the adjustment or amend its Transfer Pricing filing, the tax authorities would calculate the adjustment using the second quartile (median).

This would be the most important change in the Chilean Transfer Pricing regulation, as it is in line with its regional counterparts, who strongly emphasize median adjustments resulting in significant collections for penalties.

c) **Self-initiated adjustments:** taxpayers would have the ability to initiate an adjustment of their Transfer Prices transactions that do not comply with the arm's length principle, but only if the adjustment increases the tax base, i.e., a self-initiated adjustment would not be possible if the adjustment reduced taxable income or the tax base. The bill clarifies that the adjustment could be made in the income tax return and the taxpayer would be able to avoid the 40% penalty.

It is worth mentioning that these penalty reductions do not consider those referring to incomplete, untimely or maliciously false declarations, or in which the Chilean Revenue Service identified a material difference regarding intercompany transactions (Circular 29 Chilean Revenue Service of June 24, 2022).

d) **Advance pricing agreements (APAs)[2]:** taxpayers would be allowed to submit a preliminary request to the Chilean Revenue Service to ascertain the viability of concluding (or not) an APA. Furthermore, the term of an APA would be extended from three to four years and possibly to transactions during the three previous tax years. In all cases, taxpayers would be required to submit an annual report on compliance with the APA when signed.

As we can see, these updates will serve the Chilean Revenue Service to improve their transfer pricing audits and minimize the low success rate in intercompany adjustments that could not materialize due to legal loopholes in current regulations. These changes would be in force from January 2023.

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France

Research Tax Credit and Subsidies Synergies with Transfer Pricing

What is the research tax credit?

France's research tax credit, better-known as the "CIR" (*Crédit d'Impôt Recherche*), is a mechanism by which, to simplify, eligible companies in France may deduct a percentage of their R&D expenditures from their CIT (even up to a reimbursement if its CIT is below its CIR credit or if it pays no CIT). It is a widely-used mechanism in France, and per the latest data published by the government[3], in 2019 nearly 26,900 companies declared a total EUR 25.5 billion in eligible expenses, for a combined tax credit of EUR 7 billion.

Government research subsidies, CIR and Transfer Prices

Several multinational companies with R&D affiliates in France have sought to make the most of the government research subsidies and the CIR by taking them into account in

2 On December 2019, Chilean SII and the National Custom Service entered into the country's first-ever advanced pricing agreement (APA) with a taxpayer

3 https://www.enseignementsup-recherche.gouv.fr/fr/credit-d-impot-recherche-etudes-et-resultats-statistiques-46391

their Transfer Pricing policies. The French Tax Administration took issue with these policies, leading to a major judgement by the French Supreme Administrative Court clarifying how government research subsidies and Transfer Prices could be articulated[4], followed by two recent Administrative Court of Appeals judgements confirming this approach[5] could also be applied to the CIR.

In all three cases, the facts were broadly similar. A multinational corporation has a company in France ("FRCO"). FRCO provides R&D services to a foreign parent company, which remunerates FRCO on a "cost-plus" basis. FRCO is eligible for the CIR or similar government subsidies and benefits from them.

Then, in computing its cost-plus, FRCO deducts the CIR and/or subsidies from the cost base (precisely: subsidies in the Supreme Court case, CIR in the two Court of Appeals cases). In other words, if FRCO has a fully loaded cost base of 100, and benefits from a CIR and/or subsidy of 5, then it calculates its cost plus on a basis of 95 – thus effectively sharing part of the benefit of the CIR/subsidy with its foreign parent company.

This last part is what drew the ire of the French Tax Administration and led to subsequent litigation: in the French Tax Administration's view, this was purely and simply transferring the benefit of the CIR/subsidy to a foreign entity. The French Tax Administration was, however, unsuccessful in defending this opinion before the courts, which supported this method of calculation, citing that:

› The French Tax Administration did not prove that an independent R&D services provider would not have taken this tax credit into account (one might even assume, to the contrary, that a French services provider would leverage the CIR/subsidy as a competitive advantage).
› The services contracts explicitly stated that the cost-plus would be calculated whilst taking into account any tax credits or other state subsidies.
› The French Tax Administration did not at any time prove that the taxpayer earned less than a comparable independent company in a similar situation would have.

These court rulings therefore seem to pave the way for consistently deducting the CIR and/or similar subsidies from any R&D cost-plus services provided by eligible French companies. However, the authors can only highlight the importance of carefully documenting the process–by having both a complete Transfer Pricing documentation and well-drafted contracts, which were essential in obtaining positive judgements–so as to limit the risk of being successfully challenged by the French Tax Administration.

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4 Supreme Administrative Court, 19.09.2018, no.405779, min. c/ Sté Philips France – the authors of the present article were involved in defending this case

5 Administrative Court of Appeals of Versailles, 29.03.2022, no.20VE02083 and Administrative Court of Appeals of Paris, 16.08.2022, no.21PA00668

Indonesia

Introduction of New Transfer Pricing Methods

Before the enactment of the Harmonization of Tax Laws in late 2021, Indonesia recognized five Transfer Pricing methods: (i) comparable uncontrolled price method, (ii) resale price method, (iii) cost-plus method, (iv) profit split method and (v) transactional net margin method. With the Harmonization of Tax Laws, there are three additional methods, which are: (i) comparable uncontrolled transaction method, (ii) tangible asset and intangible asset valuation and (iii) business valuation.

Further guidance of the above methods shall be stipulated in the implementing regulation. In view of current Transfer Pricing regulations, the *comparable uncontrolled transaction method* shall be applicable to determine the arm's length price of interest rates, discounts, provisions, commissions and the royalty percentage for sales or operating profit. As for *tangible asset and intangible asset valuation,* it shall be applied in accordance with the applicable tax regulation concerning valuation, and shall be appropriate for the following transactions: transfer of tangible and/or intangible assets; rental of tangible assets; use or right to use of intangible assets; transfer of financial assets; transfer of the right with regarding to the mining business and/or other relevant rights; and transfer of right in relation to plantations, forestry business and/or other relevant rights. The *business valuation* shall be applied in accordance with the applicable tax regulation concerning valuation, and shall be appropriate for the following transactions: business restructuring including transfer of functions, assets and/or risks among related parties; transfer of assets other than cash to limited liability companies, partnerships and other types of corporations as paid-up capital in lieu of shares; and transfer of assets other than cash to shareholders, partners or members of limited liability companies, partnerships or other corporations.

Furthermore, the Harmonization of Tax Laws also indicates the use of *local benchmarking*. Although implementing regulations on this provision are expected, local benchmarking may be adopted for the taxpayer having lower operating profit than other taxpayers in comparable business or incurring unreasonable losses (although it has been carrying out commercial activities for five years). Benchmarking with other taxpayers in comparable businesses may be performed to determine the 'should-be' tax payable. This new provision may enable the tax office to assess arm's length pricing based on their internal database.

In our view, the introduction of the above new methods signifies the government's commitment to tackling Transfer Pricing risks and other base erosion and profit shifting risks by providing expanded method options to taxpayers, while at the same time promoting the legal basis for the preparation of Transfer Pricing documents. For example, the use of business valuation as a method to determine the arm's length price of business restructuring among related parties corresponds with the current regulation where such transactions shall be carried out based on the market value.

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Italy

New Arm's Length Range is set for Transfer Pricing

The Italian Tax Agency has issued instructions, through Circular Letter No. 16/E of May 24, 2022, with respect to the correct and practical use of the "arm's length range" for the application of the Italian Transfer Pricing rules.

The Circular Letter clarified various principles that have already been adopted in the case of APAs and by most taxpayers, but that have sometimes been disregarded by local tax offices in the tax audits. The guidelines under discussion should be considered under the framework of the domestic provisions of the Ministerial Decree of May 14, 2018. These provisions implemented the most recent principles adopted by OECD Guidelines, in which a range of figures must be considered consistent with the arm's length principle if they consist of financial indicators (to be selected by applying the "most appropriate method") of independent parties, assumed as comparable to the tested party.

Under the described scenario, the Italian Tax Administration confirmed, in the Circular Letter No. 16/E, the following main issues:

- The arm's length principle (and the most appropriate method applicable on a case-by-case basis) usually triggers a range of comparable/financial indicators that should be equally reliable, and differences in the range are caused by the fact that the application of the arm's length principle produces an approximation of conditions that would have been agreed among independent enterprises or by the application of different prices for comparable transactions.

- Transactions between independent enterprises that have a limited degree of comparability should be eliminated from the final benchmark set.

- Other comparability mismatches should be eliminated using "statistical tools" (e.g., the interquartile range) or the application of more than one method. In such cases, each range could be used to define an acceptable range of arm's length figures or to reconsider the accuracy of the adopted methods.

- A substantial deviation among the data included in the benchmark could suggest that some of them are not reliable, therefore, if comparable entities realizing exceptionally high profit or losses (so-called "outliers") could have a material impact on the adopted PLI and further analyses are required, by excluding results not consistent with normal market conditions or reflecting a level of risks not comparable to the tested party.

- Loss-making transactions or enterprises should not be rejected out of hand but should be assessed based on specific facts and circumstances and therefore need further in-depth analysis.

In the case of a tax audit, the taxpayer shall provide proper supporting documentation to demonstrate that the controlled transaction satisfies the arm's length principle. If the taxpayer does not provide such evidence, the tax administration is permitted to assess a new arm's length value, considering the following:

- If the benchmark includes comparables of equal and high reliability, the financial indicator is adjusted by positioning from the lower or higher range value (the so-called "full range").

- Where the benchmark was subject to adjustment, the "full range" is considered as not applicable since it is not sufficiently reliable, and the first interquartile or third interquartile shall be deemed as a reliable positioning of the arm's length range (the so-called "statistical range").

- The use of a central value within the range (the median) shall be advisable to limit discrepancies deriving from a limited comparability between the controlled transaction and the relevant benchmark.

Therefore, if the PLI should fall within the arm's length range (either full or statistical range) at the time the Transfer Pricing documentation is prepared, no adjustment will be necessary.

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Poland

Administrative Courts condemn Tax Authorities' unlawful Practices regarding the Questioning of Benchmarking Studies

The interest of the Polish Tax Authorities in benchmarking studies increases. Benchmarking studies are being carefully audited and regularly challenged during the tax controls, resulting in tax assessments and further tax proceedings before the administrative courts.

The Polish tax authorities tend to challenge the benchmarking studies based on their own studies or comparables collected from third parties (for example from banks or financial institutions). In most cases, such studies neither follow the standards set by OECD Guidelines Chapter III nor the Polish regulations.

The other questionable practice is claiming the value of median of the interquartile range as the only correct indicator of the arm's length principle.

Recently, two breakthrough verdicts of the administrative courts were issued that could stop such practices.

In the first case, the Supreme Administrative Court in the verdict of 29 June 2022 (II FSK 3050/19) dismissed the appeal of the Tax Chamber on the verdict of the District Administrative Court. The Supreme Administrative Court acknowledged the District Administrative Court position (in favour of the taxpayer) that the benchmarking study was not aligned with the steps of the comparability analysis as outlined in the Polish regulations being an arbitrary assessment that could not be considered a reliable approximation of the arm's length value.

The case in question pertained to the intercompany loan granted for the investment in the real property. The main objection of the courts was that the tax authority disregarded information about the taxpayer's business, economic environment, objective of the loan and the risks associated with the investment in real property.

In the second case, the District Administrative Court in the verdict of 9 June 2022 (Supreme Administrative Court/Go 103/22) stated that there are no legal grounds for a tax assessment based on the median of the interquartile range established under the benchmarking study, as each value in the interquartile is arm's length. In such a case, the tax assessment shall be made up to the lower quartile.

Notwithstanding these two positive verdicts for the taxpayer, it is highly recommended that the comparable studies follow comparability analysis principles as set out in the OECD Guidelines Chapter III. Moreover, the search methodology and economic reasoning should be properly documented in a narrative report and include all the obligatory elements, which are:

- a description of the comparable data search, selection process and the data sources, justification of the selection of the search criteria and the assumptions made,
- a justification of the reasons for adopting multiple years' or single year's data approach,
- a justification of the choice of the financial indicator,
- a description of the comparability adjustments and a justification of their application,
- an indication of the point or range established as a result of this analysis together with a description of the statistical measures,
- comparative data presented in an editable electronic format.

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Saudi Arabia

Amending Transfer Pricing Instructions to apply to Zakat Payers

- July 4, 2022 saw the Saudi Tax Authority, Zakat, Tax & Customs Authority, issue a document for public consultation regarding proposed amendments to the Transfer Price bylaws to be applied to Zakat payers. The document was valid for public consultation until July 30, 2022. Zakat, Tax & Customs Authority has issued results relating to the public comments received on the public consultation platform.

- It is expected that the final bylaws will be released within 2 months thereafter, however the proposed amendments do not specify the effective date of their application.

  In general, the changes were made to the definitions & nomenclature in the Transfer Price bylaws. Zakat, Tax & Customs Authority made many amendments to the wording of this article including changes, additions & deletions, so as to expand the application of bylaws both with regard to tax and Zakat.

Key amendments suggested by the Zakat, Tax & Customs Authority

- Considering the amendments proposed by the Zakat, Tax & Customs Authority, the Transfer Pricing provisions scope will be expanded to Zakat payers; accordingly, all transactions should comply with the arm's length principle in this regard.

- In other words, according to the proposed amendments, Zakat payers should be able to demonstrate and document the arm's length nature of their controlled transactions as well as maintain a rigid Transfer Pricing policy in order to avoid Zakat, Tax & Customs Authority adjustments to the Zakat base of the group entities.

- Considering that, the Zakat, Tax & Customs Authority may amend profits of certain entities in the absence of the relevant analysis and supporting documents illustrating the arm's length nature upon request of such documentation.

- Moreover, Zakat payers should adhere to Transfer Pricing compliance requirements with regard to the threshold amounting to SAR 6 million. Local and master files should be prepared and maintained.

- This would represent a significant change, as Zakat payers are not subject to transaction pricing provisions except for the obligation to submit a country-specific report. Therefore, Zakat payers will have to ensure that the neutral price principle is applied with regard to their transactions with associated companies and to fulfil the obligations & requirements of annual documents.

Implications

Zakat payers should be ready to comply with the proposed requirements when the amendment comes into effect and to be well-prepared regarding the proposed changes through documentation of the controlled transaction as well as reinforcement of robust Transfer Pricing policies.

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Senegal

Transfer Pricing: Systematizing the Control of Reporting Obligations

Since 2018, the Senegalese government has instituted reporting and documentary obligations in Transfer Pricing in accordance with the OECD BEPS actions 8–10, 12 and 13. However, it must be recognized that Transfer Pricing tax litigation is not yet abundant in Senegal, even though the regulatory framework is constantly being strengthened as a result of the various tax reforms that have already been discussed in previous issues of this newsletter. This situation in Senegal can be justified, partly, by the embryonic state of the current Transfer Pricing regulatory framework coupled with the lack of sufficient Transfer Pricing control skills.

However, it should be noted that the year 2022 marks an important turning point in the control of Transfer Pricing by the Senegalese tax administration. Indeed, we have witnessed what could be described as the "systematization" of tax audits limited to compliance with Transfer Pricing reporting obligations.

As a reminder, together with their corporate tax return, the taxpayers concerned are required to file a summary declaration on Transfer Pricing in accordance with the provisions of Article 31 bis of the Senegalese General Tax Code. Failure to comply with this obligation exposes them to a fine of XOF 10 million (EUR 15,245). However, until now, these failures were only identified and punished during the auditing of taxpayers' accounts.

This year, the Senegalese Tax Authorities have made the control of this reporting obligation almost systematic, resulting in the notification of penalty notices (procès-verbaux) addressed to almost all taxpayers who have failed to comply with their Transfer Pricing reporting obligations for the year 2021.

Thus, with the systematic application of penalties, not only does the tax administration reinforce the control exercised until now on Transfer Pricing, at the same time it reaffirms its commitment to properly implement the BEPS Actions 4, 12 and 13.

This new turn of events should lead taxpayers to increase their compliance with the Transfer Pricing tax regulations.

Similarly, the systematic application of tax penalties could prove to be a deterrent, especially as they are more severe for other Transfer Pricing reporting and documentation obligations. As a reminder, failure to comply with the above obligations is sanctioned as follows:

- **For the country-by-country declaration:** failure to file the declaration within the legal deadlines exposes the offenders to a fine of XOF 25 million (EUR 37,916.46) according to the provisions of the Senegalese General Tax Code.
- **For the obligation for the audited taxpayer to present its Transfer Pricing documentation at the start of the accounting verification:** the absence of this documentation (Master file and Local file) is sanctioned by a fine equal to 0.5% of the amount of the transactions of the documents or supplements in question which have not been made available to the administration after formal notice.

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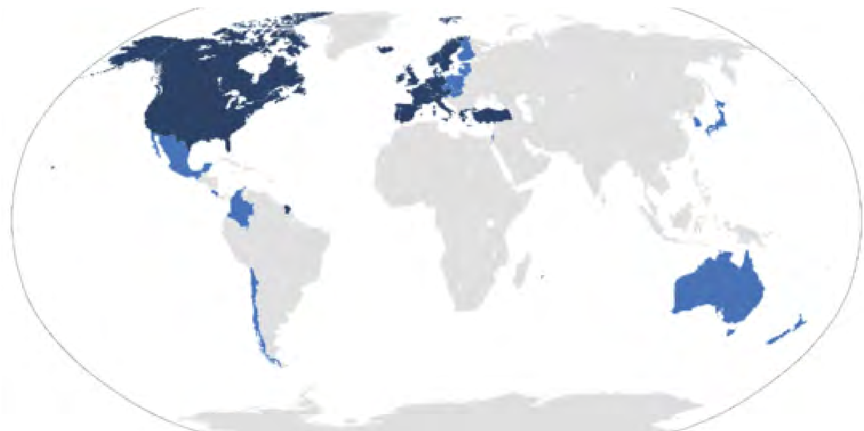
Thailand

Cash Pooling between related Companies

Cash pooling is a form of money management to ensure that all related companies in the supply chain will have enough cashflow to conduct their business. This can either be carried out by the actual transfer of money or by notation between companies. In any case, the OECD rules require that all related companies charge the market interest rate.

Although Thailand is not a member of the OECD, the Revenue Department of Thailand follows the OECD protocol regarding the arm's length principle in order to assess related party transactions.



Source: OECD. (2022). Member Countries. https://www.oecd.org/about/members-and-partners

The current practice in Thailand is that the Revenue Officers only accept interest rates that:
1. are not below the fixed deposit interest rate in Thailand; **and**
2. are not below the company's own borrowing rate; **and**
3. are not below the market interest rate.

If the interest rate charged between related parties does not comply with the above rules, the Revenue Officers have the power to adjust the interest rate and the respective company's income accordingly.

The Thai Revenue Department has published various tax rulings in the past, but the case law on this matter is limited. A notable judgement was passed by the Thai Supreme Court in 2015: the assessed company borrowed money from its foreign affiliate at the group interest rate of 5% and lent the money to its affiliate in Thailand at the same rate. However, the market interest rate in Thailand at that time was around 8%. Since the funds did not originate from the assessed company's own business operation, the Thai Supreme Court ruled that it cannot use the group rate or fixed deposit rate because these rates are below the market rate.
(Source: Thai Supreme Court judgement no. 7126/2558. https://www.rd.go.th/62688.html)

In summary, companies should set the interest rate for cash pooling as follows:
1. If the funds originate from the company's own business operation, it can use the fixed deposit interest rate.
2. If the funds originate from a third-party loan, the company should use the market interest rate or the group interest rate, whichever is higher.

Furthermore, it is important to know that companies which grant loans to foreign affiliates require a foreign business license. This makes it quite cumbersome to include Thai foreign-owned entities in a cash pooling concept.

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Ukraine

The War is not an excuse to ignore Transfer Pricing Compliance

This autumn has seen hard-fought victories of Ukrainian defenders at the frontline, criminal attacks on Ukrainian critical energy infrastructure, resulting in severe power shortages (which I had the dubious pleasure to experience while writing this note), and...Ukrainian taxpayers' struggling to comply with the Transfer Pricing reporting deadline.

Surprisingly, the Ukrainian government has not eased Transfer Pricing compliance rules, irrespective of the war. Ukrainian taxpayers had to file reports on controlled transactions by October 1 and should be ready to submit Transfer Pricing documentation (Local file in Ukrainian legislation) upon the request of the tax authorities.

The only exception is for taxpayers for whom the war made it impossible for them to comply, and this fact should be supported by evidence. Not many taxpayers have used this opportunity. Therefore, even our clients whose facilities were destroyed or remain on the territories occupied by Russians have decided to file mandatory Transfer Pricing reporting.

The rules are even more stringent compared with 2021. Thus, 2022 is the first year when the tax authorities have the right to request master files from the taxpayers belonging to international groups.
Furthermore, November 3, 2022 saw the Ukrainian State Tax Service announce that it has joined the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports. Entry into force by the set of rules on Country-by-Country Reporting was linked to this event. Hence, in 2022, taxpayers received additional Country-by-Country Reporting compliance obligations. The tax authorities, in turn, obtained new powers in the area of TP control.

Finally, on November 3, Ukrainian Parliament adopted the law by which it lifted the wartime moratorium from the selected types of tax audits. And the Transfer Pricing audits have a prominent place in this list.

The reason for "deblocking" Transfer Pricing audits is obvious. During the drastic fiscal deficit caused by the war, the government considers Transfer Pricing rules as the perfect instrument to fill in "the budget gaps".

The law has been provided to the President for signing and after promulgation it will enter into force. This is expected to happen soon.

Therefore, even if the Transfer Pricing report has been filed on time, Ukrainian taxpayers will not yet be able to breathe a sigh of relief. It is quite likely that a lot of them will soon face tax auditors "on the war path" for extra taxes.

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United Kingdom

Draft Legislation on the UK TP Documentation Requirements

On July 20, 2022, the UK government published a draft legislation with regard to Transfer Pricing documentation requirements which is expected to take effect for accounting periods starting on or after April 1, 2023.

Key changes
The draft legislation provides for regulations to be introduced that would require taxpayers to produce (and provide upon request) TP documentation in a specified format in line with the OECD recommended approach (such as Master file and Local file). In addition, HM Revenue & Customs proposed the introduction of a Summary Audit Trail. The UK had previously implemented the Country-by-Country Reporting requirement.

Since UK taxpayers are already required to keep sufficient records to demonstrate that intercompany transactions have been undertaken using the arm's length principle, it is expected that this change would only affect the format in which these records are kept. However, preparing the Summary Audit Trail might result in an additional burden for taxpayers.

It was initially stated that this legislation would only apply to the largest companies, although the term "largest" was not defined. As it currently reads, the draft legislation does not define a threshold that excludes any taxpayers (other than small and medium enterprises) from the requirement to prepare TP documentation in the specified format. However, HM Revenue & Customs has confirmed in our discussion with them that the regulations accompanying the legislation will specify the threshold, requiring only MNEs falling within the CbCR regime (i.e. with a consolidated group revenue of more than EUR 750 million) to prepare standardised documentation.

Taxpayers were previously only required to provide records to HM Revenue & Customs which they had in their possession. This has now been broadened to include TP records that are in the possession of any other legal entities of the MNE group.

Changes are also proposed to the penalties regime. Where there are any inaccuracies in documents submitted by taxpayers (e.g. tax returns) and the MNE group falls within the CbCR regime, HM Revenue & Customs will now presume that such inaccuracies are careless unless evidence can be presented to show that reasonable care was taken by the taxpayer to avoid an inaccuracy in the submitted document. Robust TP documentation prepared prior to the submission of a tax return may therefore serve as a protection from increased penalties.

Next steps

The standardised approach may provide taxpayers with more clarity in connection with the preparation of UK Transfer Pricing documentation. Most of the largest MNE businesses have already implemented the standardised OECD documentation format and therefore this legislation will have minimal impact on those entities.

Although the content of the Summary Audit Trail is as yet unknown, HM Revenue & Customs has confirmed that it will be in the form of a questionnaire to document the work undertaken by the taxpayer in arriving at the conclusions in their TP documentation. HM Revenue & Customs has also confirmed that the Summary Audit Trail will not be submitted in an electronic format; hence taxpayers will not be required to introduce any new systems to produce this document. Taxpayers will need to keep the records used to fill in the questionnaire and present them to HM Revenue & Customs upon request.

The draft regulations and the draft Summary Audit Trail will be published in December and be open for consultation.

If you have any questions about the above or would like to discuss how these changes would affect your business, please do not hesitate to contact the authors.

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Glossary

APA	Advance Pricing Agreement
BEPS	Base Erosion and Profit Shifting
CbCR	Country-by-Country reporting
CIT	Corporate Income Tax
CIR	Crédit d'Impôt Recherche
CSA	Cargill Argentine subsidiary
CSU	Cargill Uruguayan Branch
EU	European Union
FY	Fiscal Year
FRCO	Multinational corporation has a company in France
GDP	Gross Domestic Product
MNE	Multinational Enterprise
OECD	Organization of Economic Cooperation and Development
OECD Guidelines	OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
PLI	Profit Level Indicator
PRL 60	60% Profit Price Less Profit Method
R&D	Research and Development
TP	Transfer Pricing

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