



TAX ALERT

Global Transfer Pricing Insights

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Transfer pricing development continues in a rapid way as tax authorities bolster their rules in order to ensure that they claim their share of the global tax cake. Likewise, the requirements of local tax administrators on the transfer pricing are significantly increasing.

In his report, we are providing you with short insights of some of the works of the OECD members performed in the last year that might be interesting also for the Slovak taxpayers.

1 Transfer pricing – candidate for the joint tax authority audits

Background

Following the OECD Forum on Tax Administration (FTA) on 15-16 September 2010, the OECD has released a report on joint audits.

The FTA was created in 2002 by the Committee on Fiscal Affairs with the aim of promoting discussions between and among the tax administrations in the OECD member countries. Its objective is also to share information on the countries' experiences in order to improve taxpayer's compliance and administrative efficiency in a rapidly changing environment.

The OECD recognizes that in light of increased cross border transactions, tax authorities could benefit from adopting a coordinated approach, particularly for international tax risks. The report on joint audits was the output from a project undertaken by a group of 13 countries, to identify the feasibility and framework for joint audits. The report on joint audits also considers the key challenges and opportunities for tax authorities.

What is a joint tax audit?

Joint tax audit can be defined as two or more countries joining together to form a single audit team to examine an issue(s) / transaction(s) of one or more associated enterprises with cross-border business activities. All countries formed in one audit team are to receive the same presentations from the taxpayers and share the same information.

In practice joint tax audits can have many forms but the idea is the same, i.e. the tax administrations work together to investigate tax issues by sharing information on taxpayers and their related parties. International exchange of information is at the heart of an international tax audit.

Objectives of joint tax audits

Both sides, tax authority as well as the taxpayer, should benefit from joint tax audits. Main objective is to reduce taxpayer's burden, to avoid double taxation of the taxpayer, as well as to improve mutual collaboration of the tax authorities.

Conclusions

Only time will reveal the true impact on taxpayers of joint tax audits in practice. Mazars in Slovakia, together with its colleagues from the international transfer pricing team, will surely watch with interest for further developments in this area. Any

interesting insights will be brought to you through further Transfer pricing insight editions.

2 Transfer pricing Guidelines revision

On 22 July 2010, the OECD council approved the 2010 version of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ('OECD Guidelines'). Chapters I-III were substantially revised, with new guidance on the selection and application of transfer pricing methods and on comparability analysis. A new Chapter IX on the transfer pricing aspects of business restructurings was added. In following paragraphs, we will shortly guide you with details related to the most important changes. Revised changes have been also extensively consulted with the professional public.

2.1 Revision of Chapter I-III, the key changes

Hierarchy in transfer pricing methods application

'Hierarchy' in the transfer pricing methods application was replaced by application of the 'most appropriate method for a particular case'. However the traditional transaction methods (i.e. Comparable uncontrolled price method; Resale minus method; Cost plus method) are regarded as most direct means of establishing the arm's length range, transactional profit methods (Transactional net margin method and Transactional profit split method) can be applied in an equally reliable manner. It is no more needed to perform a detailed analysis and rejection of all alternative transfer pricing methods. Usually some methods will be easily eliminated as not being the most appropriate based on simply a high-level analysis of the comparability factors.

Comparability analysis

The revised Transfer pricing Guidelines provides relatively detailed guidance on the comparability analysis. Paragraphs of the revised chapters also discuss the importance of comparability analysis and suggest performing this analysis in following nine steps:

- ➔ Determination of years to be covered;
- ➔ Broad-based analysis of the taxpayer's circumstances;
- ➔ Functional analysis;
- ➔ Review of existing internal comparables, if any;
- ➔ Determination of availability of external comparables;
- ➔ Selection of most appropriate transfer pricing method;
- ➔ Identification of potential comparables;
- ➔ Determination and making comparability adjustments where appropriate;
- ➔ Interpretation and use of data collected, determination of the arm's length remuneration.

Conducting of comparability analysis as discussed above should lead to finding the most reliable comparables and selection of the most appropriate transfer pricing method, both to the circumstances of the case.

2.2 New Chapter IX, the key points

Recognition of wide spread phenomenon of business restructuring by multinational enterprises ('MNE') led to setting up guidance on the transfer pricing principles in this area. In the context of this chapter, business restructuring is found as the cross-border redeployment by a multinational enterprise of functions, assets, and/or risks. Business restructurings are typically accompanied by a reallocation of profits among the members of the MNE group, either immediately or over a few years. This chapter only covers transactions between associated enterprises in the context of the arm's length principle defined in the Model Tax Convention.

The OECD Guidelines also recommend following information to be included in a transfer pricing documentation in the case of business restructuring:

- Functional analysis and comparable analysis "before and after" the restructuring arrangements;
- Description of the actual changes occurred upon the restructuring;
- Business reasons for the restructuring;
- Anticipated benefits from the restructuring;
- Eventually other options that would have been realistically available to the parties at arm's length.

Important is to note that arm's length principle should be measured in both enterprises that are touched by the restructuring process.

Conclusion

The above mentioned revised OECD Guidelines will help multinational enterprises create transfer pricing documentation much closer to the requirements of the tax administrators. Revised transfer pricing policies and principles could prove that the taxable profits of MNEs are not artificially shifted out of their jurisdiction into the low-tax ones. Furthermore, the OECD Guidelines also help reduce and resolve disputes between tax authorities.

Many of the revisions of Chapters I-III are clarifications rather than actual changes to the concept in the previous versions. When following the revised OECD Guidelines, local legislation on the transfer pricing should be also taken into consideration.

Slovak transfer pricing legislation refers to the transfer pricing principles set up in the OECD Guidelines. However it must be noted, that hierarchy of the transfer pricing methods application still has not been changed according to the revised OECD Guidelines. Slovak income tax act (595/2003 Coll.) still requires firstly to try to apply the traditional transactions method. Just after analysis that these methods cannot be applied in a reliable manner the taxpayer can apply any of the transactional profit methods.

Another question that is raised in this case is the date of the application of the revised OECD Guidelines for the Slovak taxpayers. We are of the opinion that for any transfer pricing studies prepared after 22 July 2010 (also transfer pricing studies for tax periods that prior to 22 July 2010); the revised OECD Guidelines might be applied. But final opinion should be decided by the Ministry of Finance. We are currently waiting for their attitude. We will keep you informed through further Transfer pricing insight editions.

Should you have any questions regarding information above or be interested in a Mazars presentation of tax advisory services and other services, please contact our specialists:

Milan Šaran

e-mail: milan.saran@mazars.sk

Zuzana Pešková

e-mail: zuzana.peskova@mazars.sk

Mazars Tax k.s.
Suché mýto 1
811 03 Bratislava

tel.: +421 2 59 20 47 00

fax: +421 2 59 20 47 03

www.mazars.sk

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