DECEMBER 2015 ISSUE 18
WWW.BDOINTERNATIONAL.COM

BDO

TRANSFER PRICING NEWS

AUSTRALIA
Recent developments
READ MORE 2

ISRAEL
New transfer pricing Decree
READ MORE 8

NETHERLANDS
Transfer pricing documentation and Country-by-Country Reporting
READ MORE 11

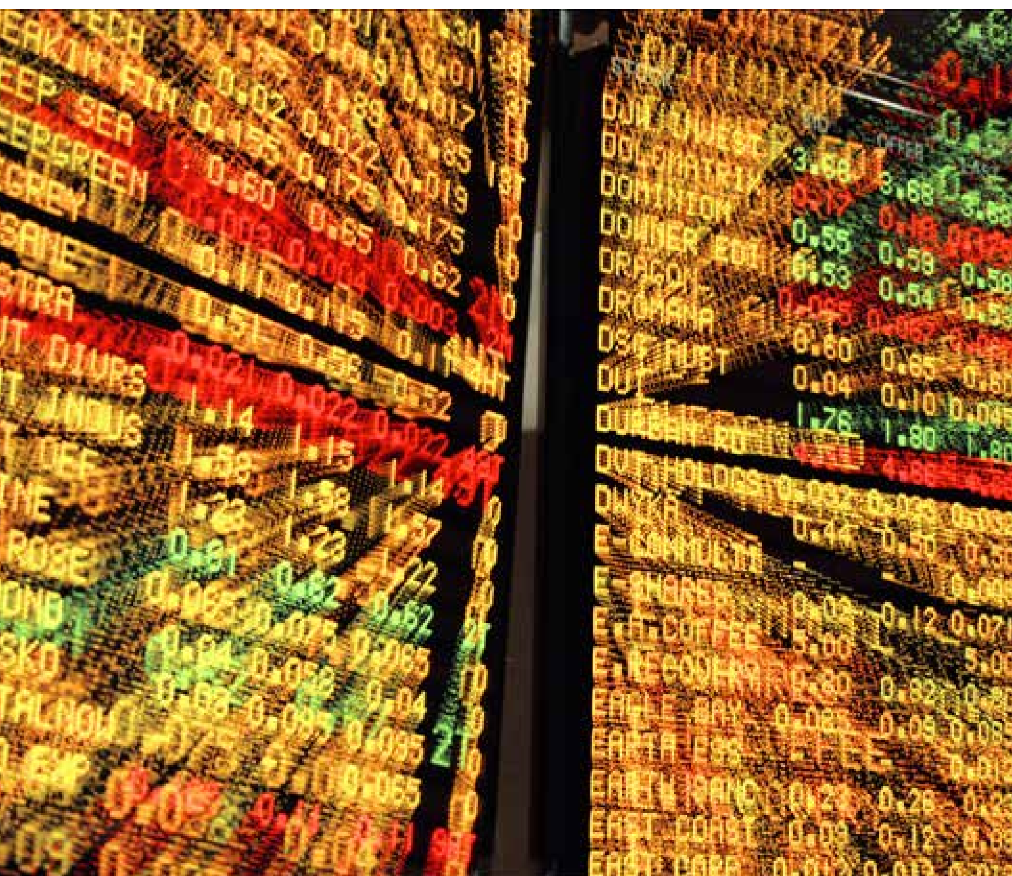
INTRODUCTION

Transfer pricing is increasingly influencing significant changes in tax legislation around the world. This 18th issue of BDO's Transfer Pricing Newsletter focuses on recent developments in the field of transfer pricing in Australia, Israel, the Netherlands, and India. Transfer pricing is becoming increasingly important for both tax authorities and tax payers around the world, with various countries introducing new legislation and guidance with respect to transfer pricing. As you will read, various countries are also showing initiatives following the finalisation of OECD's BEPS project, which are expected to expand over the coming months.

We are very pleased to bring you this 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.

CONTENTS

- INTRODUCTION
- AUSTRALIA
  Recent developments
- INDIA
  International brand promotion – the transfer pricing tangle
- ISRAEL
  New transfer pricing Decree
- NETHERLANDS
  Transfer pricing documentation and Country-by-Country Reporting



AUSTRALIA

RECENT DEVELOPMENTS

The Australian transfer pricing landscape is constantly evolving, with new transfer pricing rules, regulations and the release of the decision in the Chevron case on 23 October 2015. Given the extent of these developments, we provide an overview of some of the key changes and the impact this may have on businesses that operate or seek to operate in Australia.

1. Revisions to the Australian transfer pricing legislative framework

Australia updated its transfer pricing legislation during 2013, resulting in some key changes and consequences for how Australian taxpayers manage their transfer pricing. The new rules apply to income years commencing on or after 29 June 2013.

In brief, the requirements under the new rules include:

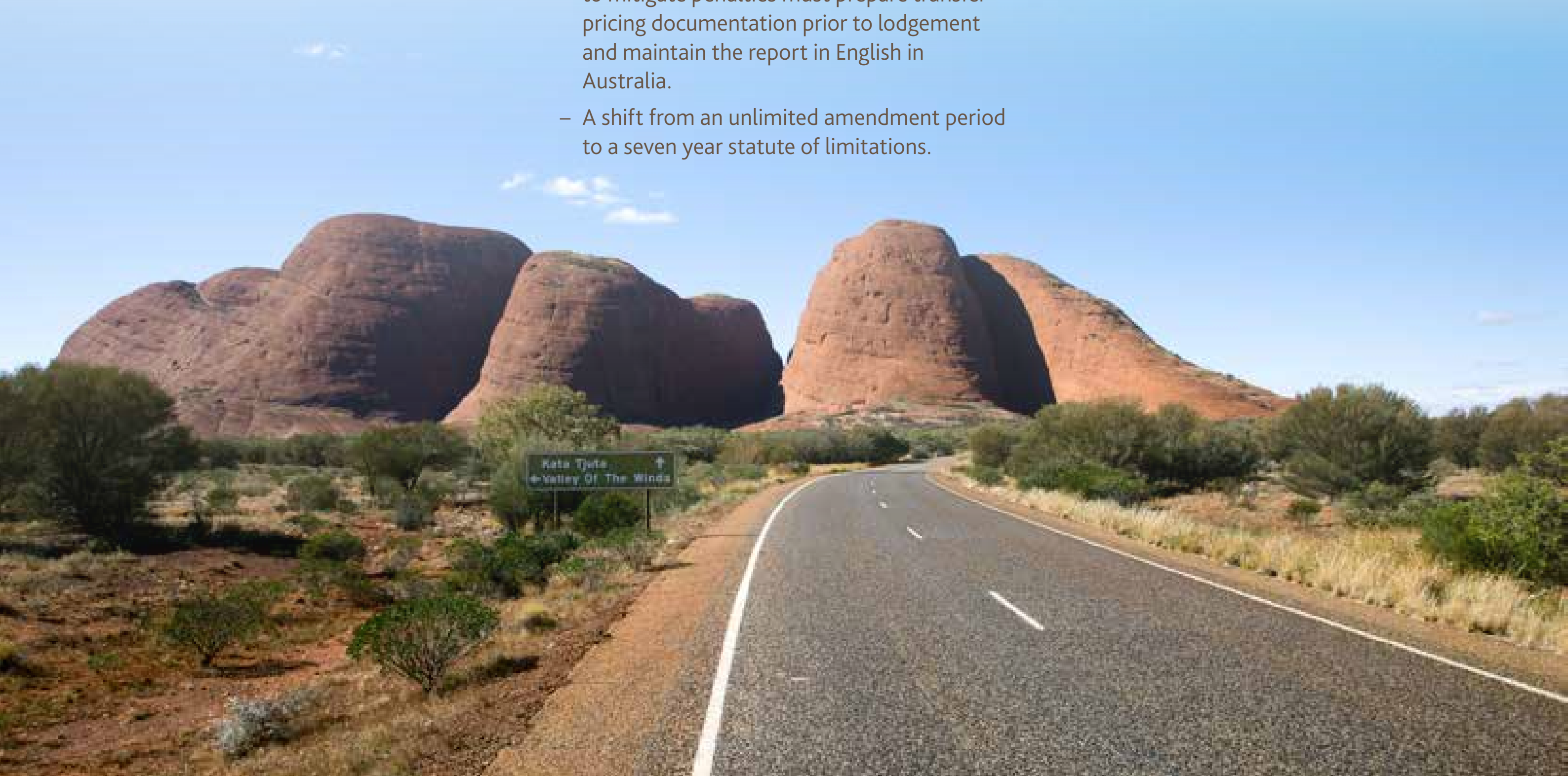
- A requirement for the Public Officer of a taxpayer to self-assess its transfer pricing arrangements upon lodging the tax return. Where adjustments are made in the tax return (and not in the accounts) it can lead to double taxation, so it is highly recommended that taxpayers ensure that any transfer pricing adjustments are made before the year end.
- A focus on the 'arm's length conditions', which are the conditions that might be expected to operate between entities dealing wholly independently with one another in comparable circumstances. This may require an arm's length allocation of profits between relevant entities. This focus is consistent with the OECD revised guidance on risk, intangibles and cost contribution arrangements.
- Reconstruction provisions which allow the actual transactions to be substituted for a hypothetical arm's length transactions in certain circumstances, for example, looking at substance over form arrangements.
- Penalty provisions that are linked to whether a taxpayer's transfer pricing documentation is prepared prior to the lodgement of the tax return and satisfies the 'reasonably arguable position' test. All taxpayers wanting to mitigate penalties must prepare transfer pricing documentation prior to lodgement and maintain the report in English in Australia.
- A shift from an unlimited amendment period to a seven year statute of limitations.

2. ATO releases guidance on preparation of documentation under new rules

The law sets out what transfer pricing analysis is required in order to achieve penalty protection. To assist taxpayers understand these requirements, the ATO has released guidance in the form of Taxation Ruling 2014/8 which details the suggested framework for the preparation of transfer pricing. The transfer pricing documentation should consider and address the '5 key questions' outlined below:

- **Question 1**: What are the actual conditions that are relevant to the matter (or matters)?
- **Question 2**: What are the comparable circumstances relevant to identifying the arm's length conditions?
- **Question 3**: What are the particulars of the methods used to identify the arm's length conditions?
- **Question 4**: What are the arm's length conditions and is/was the transfer pricing treatment appropriate?
- **Question 5**: Have any material changes and updates been identified and documented?

The ATO recommends that taxpayers consider all 5 key questions in light of their own facts and circumstances, including the relative complexity and materiality of their relevant dealings and their self-assessment risk. A minimum level of supporting evidence and documentation will be required at the time of lodging the tax return to be able to form a reasonable view of whether the transfer pricing arrangements were arm's length during the year under review. Typically, the level of analysis required to arrive at such a view is likely to depend on the risk and complexity of the transfer pricing arrangements.



3. ATO releases revised APA policies and procedures

The ATO has released Practice Statement Law Administration (PSLA) 2015/4 which details the ATO's revised advance pricing agreement (APA) program. Key changes include the introduction of a formal APA Program Management Unit, referred to as an ATO Triage function, and more transparent insights into the factors impacting taxpayer's chances in entering into the APA program. The Practice Statement also emphasises that the ATO APA teams will be moving towards applying a 'whole of tax code' approach in reviewing APA applications as opposed to focusing solely on direct transfer pricing issues. For example, matters dealing with withholding tax and carry forward losses would be considered as part of the APA application.

Key implications from the revised APA program

In most cases, the work required before being accepted into the APA Program has increased. The PSLA indicates that the ATO continues to encourage and support taxpayers into entering into APAs where possible. However, simultaneously, the ATO emphasises that going forward, a greater level of due diligence will be applied which will be more apparent at the early engagement stage. With the new PSLA, there is an expectation that there will be more upfront work required before being accepted into the APA program. Therefore, companies who have previously concluded an APA under the old regime may find that additional work needs to be undertaken before they apply for a renewal of their APA.

Are APAs still a valuable tool to manage risk?

Minimising transfer pricing risk in Australia through an APA is still a viable alternative for multinational companies to get ahead of the curve ball and ensure there are no surprises. Multinational companies in Australia will need to determine whether entering into an APA is the right avenue, and this will require greater consultation and collaboration with advisors. The Australian BDO transfer pricing team has extensive experience in successfully negotiating APAs, resolving disputes and maintaining good working relationships with the ATO.

4. Country-by-Country reporting – Enshrining OECD transparency measures into Australian law

The Australian Treasury has released exposure draft legislation which will insert into Australian law Subdivision 815-E to implement Action 13 of the BEPS project, i.e. the introduction of new standards for transfer pricing documentation and Country-by-Country (CbC) reporting to enable tax authorities to better identify and tackle transfer pricing risks. The new rules apply to Australian residents or foreign residents with an Australian Permanent Establishment with annual global revenues of AUD 1 billion. Therefore these rules apply even if the local Australian subsidiaries are small.

What do businesses exceeding the AUD 1 billion threshold need to do now?

The new regulations apply for accounting periods commencing after 1 January 2016. This means that Australian headed groups with a June year end will only need to apply the rules for the year ending 30 June 2017, whilst December balancers (typically inbound investors) will have an earlier start date of the year ending 31 December 2016, i.e. this coming financial year.

Under the new draft legislation, a statement by the taxpayer is required to be lodged with the ATO covering one or more of:

- **A CbC report** – requires reporting of high-level information relating to the global allocation of a multinational group's income and taxes paid, as well as information about the location and main business of each constituent entity within the group.
- **The master file** – provides an overview of the multinational group's business operations that will enable tax authorities to place the group's transfer pricing practices in their global economic, financial, legal and tax contexts. It requires the group's organisational structure, its intangibles and intercompany financial activities, financial and tax positions and a description of the group's businesses.
- **The local file** – focuses on specific transactions between the reporting entity and their associated enterprises in other countries. It requires identification of relevant related party transactions, the value of those transactions, and the entity's analysis of the transfer pricing outcomes and positions.

The three reports together will provide an overview of global and local financial and operational activities of a global group, as well as the local activities, that is, full transparency for the ATO to assess transfer pricing risks. This statement will be due within one year of the year end. Therefore, the statement can be prepared at a later date than the Australian documentation which is due at the time of lodging the income tax return – usually 6 months and 15 days after the year end.

The ATO has the power to specify which of the above three documents it requires. To the extent that the Commissioner can obtain the CbC report through the (automatic) exchange of information with other Tax Authorities, it may only be necessary to supply a master and local file to the ATO.

What are the penalties for large groups for non-compliance with the new regulations?

Failure to provide a statement on time or in the approved form will not deny a company penalty protection under the existing reasonably arguable position (RAP) requirements provided they meet the existing Australian documentation requirements. However, the maximum penalty for tax avoidance and profit shifting arrangements will be doubled up to a maximum of 120% of the tax avoided for groups with an AUD 1 billion global turnover. This is perhaps the most severe penalty regime in the OECD and seems to be arbitrarily linked with a MNC's global size.

What impact will this have on my group if it falls within the new regime?

Groups have never had to file transfer pricing documentation upfront with the ATO. On a self-assessment basis, the ATO has had to rely on the tax return including the International Dealings Schedule and accounts to assess transfer pricing risks. The ATO will now be able to more easily identify mismatches between profits arising in a low tax jurisdiction with people functions and assets/risks in the CbC reporting. When a perceived risk is identified, the ATO can investigate further into the wider group and Australian transfer pricing documentation to analyse the support for the current allocation of profits and, if appropriate, pursue a risk review and/or audit.

Given the experience that the ATO is gathering through International Structuring and Profit Shifting program/BEPS audits, there is a much higher risk of the ATO identifying exposures and commencing an audit than ever before.

5. Multinational Anti-Avoidance Law

On 16 September 2015, the Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015 (the 'Bill') was introduced into the Australian Parliament. In addition to new CbC reporting rules and stronger penalties to combat tax avoidance and profit shifting, the Bill extends Australia's current anti-avoidance rules to prevent multinational entities from using certain tax avoidance schemes to artificially avoid the attribution of profits to a permanent establishment (PE) in Australia. To reduce compliance costs, the new 'Multinational Anti-Avoidance Law' (MAAL) will only apply to foreign entities that are either parent entities (or members) of a multinational group with global revenues of AUD 1 billion or more (defined as 'significant global entities').

The Bill has broadened the scope of the original draft MAAL which was released in May 2015 by removing a condition for the rules to apply only where multinationals operated in a low or no tax jurisdiction. The MAAL will now apply where:

- A foreign entity derives income from making supplies (i.e. of goods and services, including electronic downloads, IP rights, rights to priority in search functions etc.) to Australian 'arm's length' customers;
- There is an entity in Australia that is an associate of, or commercially dependent on, the foreign entity, which supports the making of those supplies;
- The foreign entity avoids the income derived from the supply being attributable to a PE of that foreign entity in Australia; and
- It is concluded that the scheme was entered into or carried out for the principal purpose (or for more than one principal purpose) of obtaining an Australian tax benefit, or obtaining both an Australian tax benefit and a reduction (including a deferral) of foreign tax.

In essence, the provisions seek to target schemes where income from sales between a foreign entity and Australian third party customers is booked overseas, while an affiliated (or commercially dependent) Australian entity performs activities viewed as integral in securing the Australian sales (e.g. marketing, sales support, warehousing activities), but with no income being attributed to Australia in respect of the Australian sales.

Where the rules are found to apply, the foreign entity will likely be deemed to have a notional PE in Australia, with Australian sales revenue and allowable deductions being attributed to the notional Australian PE (based on Australian PE transfer pricing principles). The new rules will apply on or after 1 January 2016 whether or not the scheme was entered into, or was commenced to be carried out, before that day.

With the Bill expected to be enacted unobstructed, foreign entities with global revenues of AUD 1 billion or more entering into sales contracts directly with Australian third party customers, and having affiliated or dependent Australian entities undertaking activities in direct support of the Australian sales, should review their current arrangements now to ascertain the potential impact of these changes.

While the Explanatory Memorandum to the MAAL states that the new measures are specifically targeted at 30 large multinational companies and may impact up to 100 companies, the Treasurer's second reading speech in relation to the Bill identified up to 1,000 multinationals which potentially could be impacted by the new measures.

6. ATO wins first landmark transfer pricing case against Chevron Australia

In a landmark transfer pricing case[1] the Australian Federal Court has held that Chevron Australia did not provide sufficient evidence to prove that the consideration on an intra-group financing arrangement was the arm's length consideration or less than the arm's length consideration, nor proved that the ATO's amended assessments were excessive. This was very much based on the Judge not accepting the extensive arguments provided by a number of witnesses for Chevron Australia.

The Judge found in favour of the Commissioner under both the old transfer pricing rules in Division 13 of Income Tax Assessment Act 1936 and the revised transfer pricing rules in Subdivision 815-A of Income Tax Assessment Act 1997[2]. In relation to Subdivision 815-A which is retrospectively applied, the judge decided that it was constitutionally valid.

The key implications arising from the case include the following:

- The case highlights that to the extent taxpayers cannot discharge the onus of proof through proper analysis and documentation evidence it will be difficult to defend their transfer pricing arrangements from ATO scrutiny.
- Taxpayers should review their intra-group financing arrangements to consider whether any economic analysis performed, in relation to determining the appropriate interest rate applied to their intra-group financing arrangements, takes into consideration all appropriate factors, including the financial resources available to the borrower that an arm's length lender would regard as relevant to the pricing of the loan.
- In addition to tax and interest, penalties of approximately AUD 45 million (i.e. 25% of the scheme shortfall amount) were imposed, as the judge found the dominant purpose of the refinancing arrangement was to enter into a scheme, for which the sole or dominant purpose was to derive a benefit from the scheme. In the Chevron case, another entity in the US borrowed funds at a low interest rate (due to a guarantee from Chevron Corp) and on-lent funds to Chevron Australia at a higher interest rate which generated a large profit for the lender.
- This decision is reported just two weeks after the OECD announced its final Base Erosion Profit Shifting (BEPS) package, in which many countries around the world have endorsed a number of actions explicitly designed to tackle perceived tax avoidance by multinational groups.
- More broadly the case is likely to empower the ATO to continue its pursuit in reviewing the transfer pricing positions of multinationals, and taxpayers will need to be prepared to support their case.

Chevron Australia is considering an appeal against the Federal Court judgement.

Given the constantly evolving Australian transfer pricing landscape, with new measures introduced to administer the Australian transfer pricing rules, it is important that taxpayers in Australia review their transfer pricing arrangements and prepare adequate transfer pricing documentation to support the arm's length nature of the arrangements.

Your BDO contact in Australia:
ZARA RITCHIE
zara.ritchie@bdo.com.au

[1] *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4) [2015] FCA 1092.*

[2] *Subdivision 815-A applies to income years commencing on or after 1 July 2004 and ceases to apply to income years to which Subdivision 815-B applies, which generally starts for income years commencing 1 July 2013.*

INDIA

INTERNATIONAL BRAND PROMOTION – THE TRANSFER PRICING TANGLE

Background

India has been on the global radar so far as controversies surrounding tax and transfer pricing are concerned. In the last few rounds of audit by the Revenue, Indian taxpayers promoting international brands in India have been scrutinised for the level of advertising, marketing and promotion (AMP) expenses incurred by them. This issue has largely affected MNEs in the consumer durables, distribution and automotive sectors, gaining such importance that a three-member special bench of the Tribunal was constituted to address it. The issue then escalated to the High Court and is now pending with the Indian Supreme Court. In this article we highlight the issues around AMP expenses in India, the positions taken by Indian taxpayers and the Revenue, and how this has evolved amongst the judiciary.

The AMP issue in India

Under a typical license/distributor arrangement, the Indian entity of a MNE group uses the International brand/trademark to sell the products in India. The Indian entity would pay a royalty for the use of such brand/trademark. In order to spread awareness of products and increase/maintain the market share of the products manufactured or distributed by them in India, the Indian entity would incur expenses on advertising marketing and promotion.

During the course of transfer pricing audits, the Revenue has consistently been taking a position that the Indian entity of the MNE group provides assistance to the overseas affiliate (legal owner of the brand/trademark) by enhancing or building the International brand/trademark in India. According to the Revenue, AMP expenses beyond the level of expenses incurred by comparable businesses (bright line test) are non-routine, resulting in the creation of marketing intangibles for the legal owner of the brand. Transfer pricing adjustments have been made on the premise that the Indian entity ought to recover the excess costs along with an appropriate mark-up for such assistance.

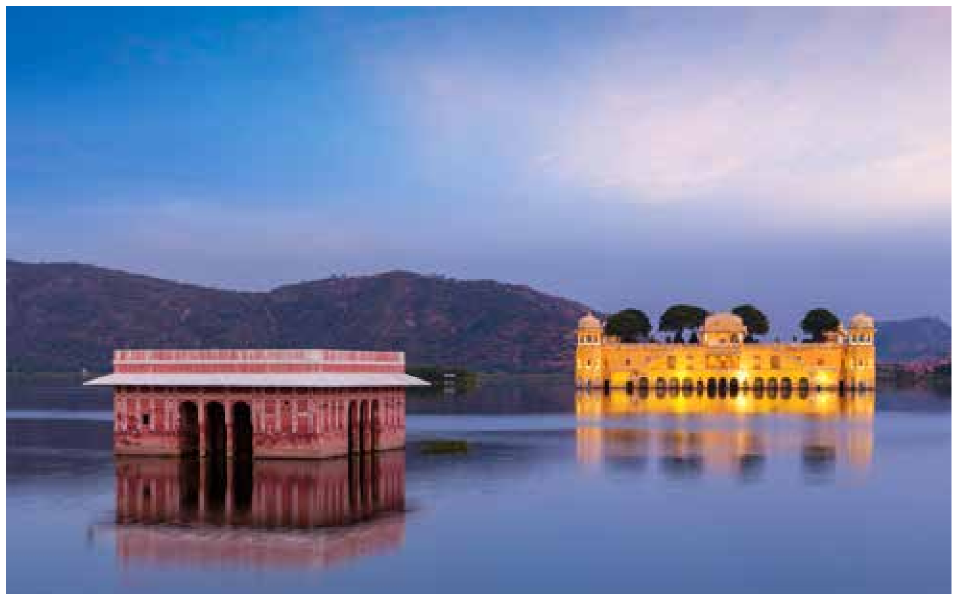
How it all started

The AMP issue can be traced back to 2010, when the Delhi High Court made a ruling in the case of Maruti Suzuki[3]. The High Court remarked that if the level of AMP expenses (defined by a ratio of AMP expense to sales) by the Indian taxpayer is higher than what a comparable company would incur, the Indian taxpayer should be compensated at arm's length, particularly when the use of a trademark or logo of the foreign affiliate is obligatory on the part of the Indian taxpayer. With a shot in the arm with this ruling, the Revenue made several transfer pricing adjustments in cases involving distributors, licensed manufacturers, service providers, etc. Without appreciating the difference in functional characterisation, business model, or industry life-cycle of the Indian taxpayers, the Revenue painted everyone with same broad brush and made transfer pricing adjustments for excess AMP expenses.

The Revenue seems to have taken inspiration from the US Tax Court ruling in 1998 in the case of DHL[4], which was subsequently reversed by the Ninth Circuit US Court of appeal[5]. In the case of DHL, the Tax Court asked DHL to prove that it incurred more than routine AMP expenses outside the US, in order to substantiate that DHL was the developer of the non-US trademark/brand rights. However, the Ninth Circuit Court of appeal rejected the approach of the Tax Court, holding that there was no such requirement to compare AMP expenses incurred by the taxpayer with comparable companies under the 1968 regulation.

Evolution of transfer pricing jurisprudence on AMP in India

More cases were appealed after the Delhi High Court ruling in the case of Maruti Suzuki. In these appeals, taxpayers challenged the legality of the transfer pricing adjustments. In one case, the Appellate Tribunal (second level appellate authority, lower to the High Court) deleted the transfer pricing adjustment on the technical ground that the transfer pricing officer (a specially designated tax officer to carry out transfer pricing audits) had no jurisdiction to assess any transaction which was not specifically referred by the tax officer assessing the case. The Revenue challenged this technical ground before the High Court but failed, no discussion being recorded on the merits of the transfer pricing adjustment. To overturn the defeat in 2012, the Government amended transfer pricing provisions through the Finance Act 2012 which in effect bestowed the right on transfer pricing officers to test transactions even if specifically not referred by the tax officer assessing the case. After this amendment, the Appellate Tribunals started adjudicating the issue on merit. However, the decisions differed in different cases, creating uncertainty around the transfer pricing implications of AMP expenses.



[3] *Maruti Suzuki India Limited Vs Addl. CIT TPO [W.P.(C) 6876/2008] [2010] 328 ITR 210.*

[4] *DHL Corporation & Subsidiaries Vs. Commissioner of Internal Revenue (T.C. Memo. 1998-461, 30 December 1998).*

[5] *DHL Corporation & Subsidiaries Vs. Commissioner of Internal Revenue (Ninth Circuit Court ruling, 11 April 2002).*

Special Bench Ruling in the case of LG Electronics India Private Limited[6] (LG India)

Considering the conflicting decisions, the importance and the complexity of the issue, in the case of LG Electronics, a three-member special bench was constituted by the Appellate Tribunal to adjudicate on the transfer pricing aspects of AMP expenses. Some other Indian taxpayers[7] also affected by the issue appealed as interveners to the case. The special bench heard both sides and decided as follows:

- AMP expenses incurred by Indian taxpayers result in creating and improving marketing intangibles for the overseas affiliates
- Expenses for the promotion of sales directly lead to brand building; expenses directly in connection with sales are only sales specific
- In addition to promoting its products through advertisements, LG India simultaneously promoted the foreign brand
- The concept of economic ownership is not found in Indian tax law. It is the legal owner of the brand who benefits
- If the level of AMP expenses incurred by an Indian taxpayer is in excess of that of comparables, the excess AMP ought to be recovered by the Indian taxpayer from the overseas affiliate along with the appropriate mark up
- Selling expenses which do not lead to brand promotion do not form part of AMP expenses and hence should be excluded for the purpose of benchmarking.

Most cases pending before Appellate Tribunals were referred back to the transfer pricing officers, with specific directions to follow the principles laid down by the special bench in the LG India case. This resulted in transfer pricing adjustments in many cases, barring some relief on account of exclusion of routine sales expenses from the ambit of AMP expenses.

Delhi HC ruling in the case of Sony Ericsson[8]

Aggrieved by the order of the tax tribunals following the decision in LG India case, taxpayers (including consumer electronics and consumer durables giants like Daikin, Haier, Reebok, Canon and Sony) appealed to the High Court. In adjudicating the Sony Ericsson case, the High Court laid down the following broad principles:

- In line with the decision of the special bench in case of LG India, AMP expenses are treated as international transactions with the associated enterprise and are thus subject to transfer pricing regulations in India
- Excess AMP expenses incurred by Indian taxpayers warrant remuneration, but the bright line test is not well suited to compute this
- Distribution and marketing functions are intertwined, and should be analysed in a bundled manner from an arm's length remuneration perspective, unless good and sufficient reasons are demonstrated for de-bundling them
- If under the bundled approach, the gross margin or net margin of Indian taxpayers is sufficient to cover the excess AMP expenses, then separate remuneration for such excess from the foreign affiliate is not required
- If the distribution and marketing functions are to be de-bundled, then the taxpayer should be allowed a set-off for additional remuneration in one function, with a shortfall in the other function
- In order to apply a bundled approach using an overall transactional net margin method (TNMM)/resale price method (RPM), it should be ensured that the level of the AMP functions in comparables should be similar to that of the Indian taxpayer or the tested entity
- An attempt should be made to find comparables with a similar level of AMP functions, and if such comparables cannot be found, then a proper adjustment should be made to even out the differences
- All AMP expenses may not necessarily result in brand building
- The concept of economic ownership of the intangibles is recognised.

The High Court also suggested that the Appellate Tribunals try to adjudicate the pending cases (rather than remitting them to the transfer pricing officer) following the broad principles laid down in the case above. However, the Tax Tribunals are in fact remitting the issue back to the transfer pricing officer on the ground that the no analysis is carried out as to the comparability in the level of AMP functions.

Unresolved issues on AMP

Although the Delhi High Court has laid down broad principles and some guidelines for computation of the arm's length price for distribution and brand promotion functions, some issues remain to be clarified when implementing the ruling in practice.

The High Court has emphasised the need for comparability of AMP function between the taxpayer and comparable entities. If companies with comparable AMP functions cannot be found, then a necessary adjustment needs to be made to even out the difference in the AMP functions. However, neither the High Court nor the Appellate Tribunals have provided any guidance on computing adjustments for differences in AMP functions.

With regard to the "set-off" of compensation for distribution function with the AMP function in the case of a de-bundled analysis, it is not clear whether the taxpayer's gross or net margin should be considered as the reference point for determining the amount of the set-off.

It is worth noting that the High Court ruling related to a distribution business, and it remains to be seen how the broad principles will be applied in other cases, like those of licensed manufacturers.

[6] *L.G. Electronics India Private Limited Vs. Asstt. Commissioner of Income Tax (ITA No. 5140/Del/2011).*

[7] *Haier Telecom Pvt. Ltd; Goodyear India; Glaxo Smithkline Consumer India; Maruti Suzuki India; Sony India; Bausch & Lomb; Fujifilm Corporation; Canon India; Diakin India; Amadeus India; Star India; Pepsi Foods India.*

[8] *Sony Ericsson Mobile Communication India Pvt. Ltd Vs. Commissioner of Income Tax (ITA No. 16/2014).*

Way forward

While the Delhi High Court ruling in the Sony Ericsson case is broadly in line with international jurisprudence on the issue, the AMP saga still seems far from over in India. A few Indian taxpayers affected by the Delhi High Court decision, i.e. Sony Ericsson, Canon India and Daikin India have filed a special leave petition before the Indian Supreme Court challenging the ruling by the Delhi High Court.

The key issue that needs consideration and deliberation is whether Indian taxpayers have incurred AMP expenses in their capacity as service providers or as an entrepreneur on their own account. The answer to this may lie in the functional analysis and conduct of the Indian taxpayer and the foreign affiliate. The issue of compensating for AMP function at arm's length would arise only in cases where the Indian taxpayer is incurring AMP expenses in the capacity of a service provider. Furthermore, indicative facts like exclusivity, longevity of contract, premium pricing and increase in the market share, etc. could be used to demonstrate the economic ownership of the brand. Documentation by the MNE group would play a key role in helping the MNE find answers, determine a course of action and/or build an appropriate defence. Consideration also needs to be given to the mode of remunerating such services. Instead of recovering AMP expenses from the overseas affiliates, MNEs could consider remunerating the Indian taxpayers by way of a higher gross margin to cover the AMP expenses. Lastly, while MNE groups evaluate their value chains in the wake of BEPS, it may be worthwhile considering the above implications while aligning ownership of IP, compensation and related structures.

Your BDO contact in India:
JIGER SAIYA
jigersaiya@bdo.in

ABHAY KUMAR
abhaykumar@bdo.in

ISRAEL

NEW TRANSFER PRICING DECREE

In the context of increased economic activity through the medium of the internet ("the digital economy"), and following the BEPS action point 1 discussions on the tax challenges of the digital economy, and action point 7, which discusses the prevention of artificial avoidance of permanent establishments ("PEs"), the Israeli Tax Authorities have issued a draft circular expressing their intention to extend the current interpretation of the PE rules to include profits derived from the digital economy. The aim is to increase the ability of the Israeli Tax Authorities to collect tax from foreign entities that have established a PE in Israel via the provision of services. This draft circular does not refer to foreign entities that sell products in Israel.

Taxation of a foreign entity

The income of a foreign entity which will be liable to tax in Israel is as follows:

- If the other country in which the foreign entity is resident has not signed a Double Tax Treaty with Israel – the income of the business activity (or some of it) which is performed in Israel.
- If the other country has signed a Double Tax Treaty with Israel – income only taxable if the business activity establishes a PE in Israel.

Establishment of a PE

A foreign entity that provides services in Israel will be regarded as establishing a PE in Israel only when it has a fixed place of business or when it performs its activity via a "dependent agent".

Fixed place of business

According to the interpretation of the OECD's model Double Tax Treaty, a fixed place of business that may establish a PE is considered to be, inter alia, where a business has placed a physical internet server.

However, according to the Israel Tax Authority's current interpretation, in the context of a digital economy, a fixed place of business that establishes a PE might be deemed to exist also where a foreign entity performs its core economic activity.

Foreign entities which operate through physical facilities in Israel that provide the foreign entities with a business activity other than an auxiliary activity might establish a PE in Israel.

Additional examples of when a PE might be established are as follows:

- The entity owns a physical facility (as well as a website) which operates a site specifically aimed at Israeli users e.g. in terms of language, currency, focused adverts and style.
- The website links Israeli customers with Israeli service providers.
- The volume of traffic on the site reflects high popularity with Israeli users.
- Representatives of the foreign entity in Israel are involved in identifying customers, or gathering clients or information in order to help stimulate Israeli-based business with the help of a physical facility in Israel.
- Significant marketing and support services are provided in Israel via the foreign entity's representative.
- Added business risks are created from the business exposure in Israel.
- A significant number of agreements to provide digital services are signed between the foreign entity and residents from the same country via the internet alone ("significant digital presence").
- The foreign entity's services are consumed in the same country to a large extent ("significant digital presence").
- The foreign entity receives significant payments from residents, related to contractual obligations for the provision of services that are part of the entity's core activity ("significant digital presence").
- A PE can be created, inter alia, when an employee contractually works for an Israeli company, yet acts according to the foreign entity's orders.
- The foreign entity is involved in the recruitment of an Israeli employee even though he is due to be employed by a separate Israeli company.

A dependent agent

Under the OECD guidelines, a PE will also be established in Israel by a dependent agent who has authority to conclude contracts on behalf of the foreign entity on a regular basis.

A dependent agent who only initiates negotiations with potential clients on the basis that this might eventually bind the foreign entity, might also establish a PE for the foreign entity.

Some examples of when an agent conducts contracts in the name of a foreign entity, and therefore might establish a PE in Israel, are as follows:

- An agent has authority to fix a price or other commercially binding terms.
- Circumstances of the contract are dictated to the agent and he has judgment regarding the circumstances.
- The agent is involved in adapting the contract to the client's needs.
- The agent is a party to the contract.

Allocation of profits to PE

After it has been determined that a PE has been established in Israel, the profits of the Israeli-based operations must be appropriately distinguished from those of the worldwide business, and this amount will be subject to Israeli tax.

The distinction would be determined according to the instructions of the 2010 OECD report on the attribution of profits to PEs.

Submitting separate reports

When it is determined that the activity of a foreign entity is performed through a PE, two separate reports should be submitted: one regarding the foreign entity's income that was derived through the PE, and the second regarding formal activity if performed by the foreign entity via an Israeli entity in Israel.

Should the foreign entity that provides services in Israel be obliged to register in Israel for VAT purposes?

The main rule derived from the VAT law in the context of a foreign entity that provides services in Israel is that a foreign entity that has activity in Israel, to the extent that it would be seen as a business, will be liable to VAT for its business activity, and would be required to register in Israel as a licensed business.

When there is a direct link between the services that the foreign entity provides to Israeli clients via the internet (that are significant) and Israel, then it is possible to determine that under those circumstances, the foreign entity performs a business activity in Israel.

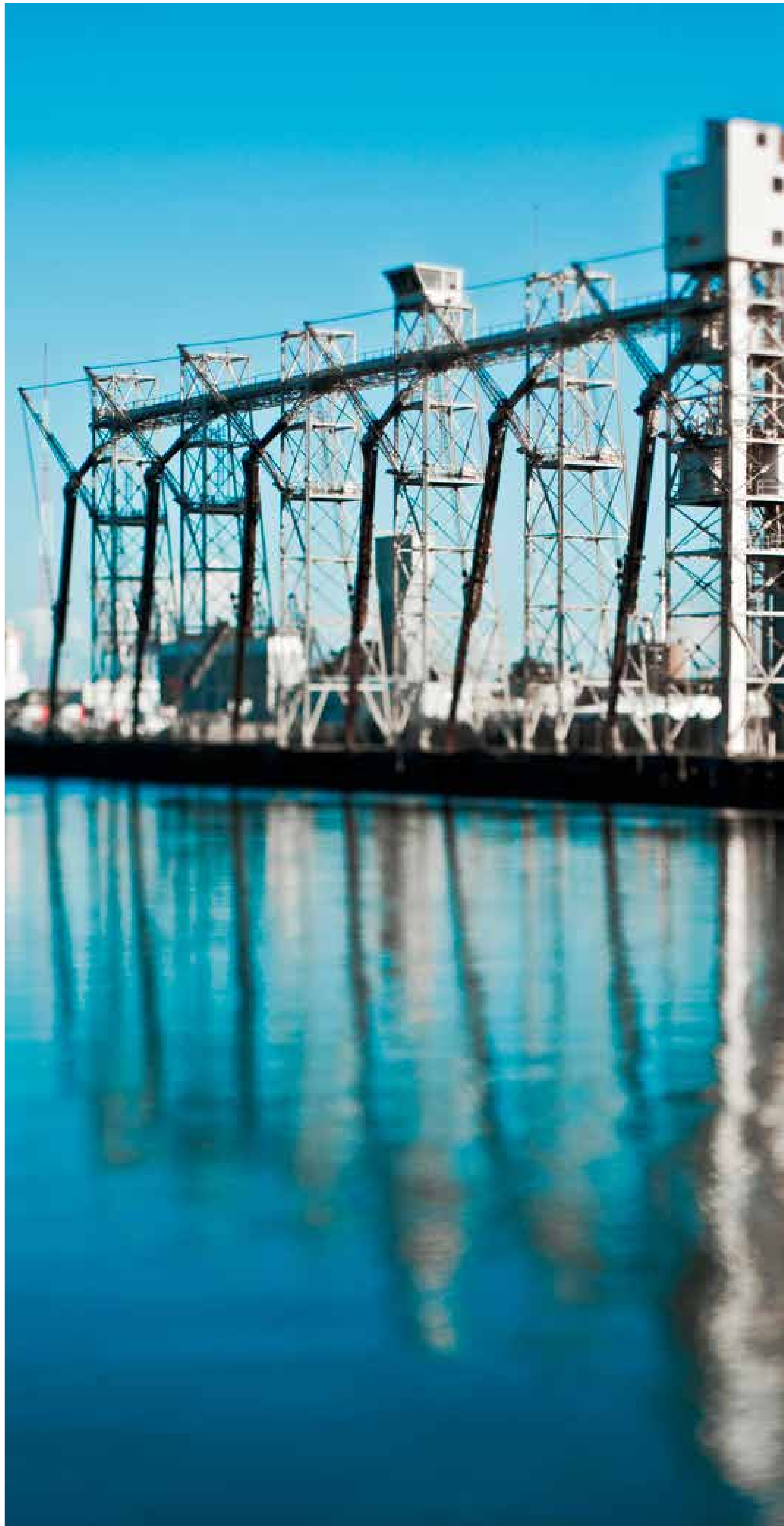
Examples of when a foreign entity might be obliged to register as a licensed business in Israel are as follows:

- A foreign entity operates a search engine providing publication services to Israeli clients that are directed to Israeli users or consumers.
- A foreign entity operates an internet website for booking rooms in Israeli hotels for Israeli clients.

In conclusion

Needless to say, the Israeli Tax Authorities (Israel being a member of the OECD) are putting much effort into collecting tax derived from activities of the digital economy.

Your BDO contacts in Israel:
AMIT SHALIT
amits@bdo.co.il



NETHERLANDS

TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING

The Netherlands has released new draft legislation implementing new transfer pricing documentation requirements in line with Base Erosion and Profit Shifting (BEPS) Action 13. Multinational enterprises (MNEs) will have to take a three-tiered (master file, local file and CbC (Country-by-Country) Report) approach to transfer pricing documentation. Under the draft law, the master file, local file, and CbC Report requirements will be applicable for fiscal years starting on or after 1 January 2016. Non-compliance will lead to legal sanctions.

Transfer pricing documentation requirements (master file and local file)

For members of an MNE group resident in the Netherlands (with a minimum consolidated turnover of EUR 50 million), additional (obligatory) transfer pricing documentation requirements are introduced. The qualifying MNE group should have a master file and local file available at the level of the Dutch entity for the previous financial year at the time of filing the corporate income tax return.

Separate Ministerial regulations will determine further rules on the form and content of the master file and local file. Under the draft Dutch legislation, the master file should provide an overview of the MNE group business, including:

- The nature of the business activities;
- The general transfer pricing policy; and
- The global allocation of income and economic activities.

Further guidance is given by the OECD which also mentions the following elements as being part of the master file (not exhaustive):

- Organisational structure;
- A brief functional analysis describing the principal contributions to value creation;
- Intangibles;
- Intercompany financing activities; and
- Financial and tax positions of the Group (such as a description of the MNE group's existing unilateral advance pricing agreements (APAs) and other tax rulings relating to the allocation of income among jurisdictions).

The local file should include information relevant to the transfer pricing analysis of inter-company transactions between the Dutch entity and a related foreign entity. This information should help to substantiate the arm's length nature of the transactions.

Information supporting the arm's length allocation of profits to a permanent establishment should be included in the local file as well.

The OECD guidance lists the following additional elements of a local file (not exhaustive):

- A description of the management structure;
- A description and the amounts of the relevant intercompany transactions;
- An indication of the most appropriate transfer pricing method and the reasons for selecting this method;
- Relevant financial information regarding the entity, intercompany transactions and comparables used in the analysis;
- A detailed comparability and functional analysis; and
- Details of APAs, and other rulings to which the Dutch tax authorities are not a party and which are related to the relevant intercompany transactions.

The Netherlands has a penalty regime regarding tax administration and the existing regime is also applicable to the master file and the local file.

It should be noted that the existing documentation requirements remain applicable for Dutch tax resident group entities that have a consolidated turnover of less than EUR 50 million. However, this may differ in a situation where the head of the MNE group is established in a jurisdiction that does not have these minimum documentation requirements in place. In that case, a Dutch entity might still be required to prepare (more) comprehensive transfer pricing documentation.

Country-by-Country Reporting

The CbC requirements apply to Dutch tax resident entities which are members of an MNE group with a minimum consolidated group turnover of EUR 750 million. The consolidated group turnover for this purpose is calculated based on the fiscal year preceding the fiscal year to which the CbC report applies. The primary purpose of CbC reporting should be a risk assessment tool for tax administrations and should be used to assess the accuracy of the transfer pricing policy applied within an MNE group.

The MNE group is obliged to provide a CbC report within one year after the end of the reporting (financial) year to the tax authorities where the ultimate head of the group is located. CbC reporting obliges companies to provide the tax authorities with:

- Aggregate, jurisdiction-wide information on global allocation of income;
- Details of taxes paid (including withholding taxes); and
- Indicators of economic activities.

CbC reports should be filed with the jurisdiction of the ultimate parent entity of a group. The ultimate parent entity of an MNE group which has its tax residency in the Netherlands is obliged to file a CbC report, apart from the corporate income tax return, with the Dutch Tax Administration. However, in specific cases, this obligation can also be on a Dutch resident group entity that is not the ultimate parent entity of the group.

Local filing or filing 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 systematic failure to exchange information in practice.

Furthermore, there will be an 'implementation package' in place to facilitate effective exchange of information, including by way of automatic exchange. The filed CbC report will subsequently be exchanged automatically with jurisdictions in which the MNE is operating, with whom the Netherlands has concluded an information exchange agreement.

The draft legislation requires all group entities which are Dutch tax resident to notify the tax inspector if they are the ultimate parent entity of the group. If the Dutch group entity is not the ultimate parent entity, it is obliged to disclose the identity and the tax residency of the reporting entity.

If the CbC reporting filing obligation is not met, penalties can be imposed to the entity. Not satisfying the requirements to submit the CbC report will be regarded as a criminal offence, and non-compliance will lead to a monetary fine.

Concluding remarks

Although the Ministerial regulations need to provide additional specifics to the new regulations, companies meeting the EUR 50 million and/or EUR 750 million condition should ensure that their transfer pricing documentation is prepared in time, and that they identified which entity within their group should file CbC reports.

Your BDO contact in The Netherlands:
SJOERD HARINGMAN
sjoerd.haringman@bdo.nl

CARINA ROMANO
carina.romano@bdo.nl

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 7 December 2015.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
Australian Dollar (AUD)	0.67392	0.73345
Euro (EUR)	1.00000	1.08763

LIST OF CONTACT PERSONS

Name		
Zara Ritchie BDO Australia	Tel Fax e-mail	+61 3 9603 1700 +61 3 9602 3870 zara.ritchie@bdo.com.au
Dan McGeown BDO Canada	Tel Fax e-mail	+1 416 369 3127 +1 416 865 0887 dmcgeown@bdo.ca
Dirk Elbert BDO Germany	Tel Fax e-mail	+49 69 95 941 438 +49 69 95 941 326 dirk.elbert@bdo.de
Michiko Hamada BDO USA	Tel Fax e-mail	+1 212 885 8577 +1 212 697 1299 mhamada@bdo.com
Sjoerd Haringman BDO Netherlands	Tel Fax e-mail	+31 10 242 4600 +31 10 242 4624 sjoerd.haringman@bdo.nl
Anton Hume BDO United Kingdom	Tel Fax e-mail	+44 207 486 5888 +44 207 487 3686 anton.hume@bdo.co.uk
Ariel Efraim BDO Argentina	Tel Fax e-mail	+54 11 4106 7000 +54 11 4106 7200 aefraim@bdoargentina.com
Jaime Zaga BDO Mexico	Tel Fax e-mail	+52 55 8503 4200 +52 55 8503 4299 jaime.zaga@bdomexico.com
Jay Tang BDO China	Tel Fax e-mail	+86 21 2328 1506 +86 21 6321 4049 jay.t@bdo.com.cn
Philip Yeoh BDO Malaysia	Tel Fax e-mail	+603 2616 2929 +603 2616 3195 philipyeoh@bdo.my
Roxanna Nyiri BDO South Africa	Tel Fax e-mail	+27 10 060 5000 +27 10 060 7000 rnyiri@bdo.co.za

This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained herein without obtaining specific professional advice. Please contact the appropriate BDO Member Firm to discuss these matters in the context of your particular circumstances. Neither the BDO network, nor the BDO Member Firms or their partners, employees or agents accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

BDO is an international network of public accounting, tax and advisory firms, the BDO Member Firms, which perform professional services under the name of BDO. Each BDO Member Firm is a member of BDO International Limited, a UK company limited by guarantee that is the governing entity of the international BDO network. Service provision within the BDO network is coordinated by Brussels Worldwide Services BVBA, a limited liability company incorporated in Belgium with its statutory seat in Zaventem.

Each of BDO International Limited, Brussels Worldwide Services BVBA and the member firms of the BDO network is a separate legal entity and has no liability for another such entity's acts or omissions. Nothing in the arrangements or rules of the BDO network shall constitute or imply an agency relationship or a partnership between BDO International Limited, Brussels Worldwide Services BVBA and/or the member firms of the BDO network.

BDO is the brand name for the BDO network and for each of the BDO Member Firms.

© Brussels Worldwide Services BVBA, December 2015 1512-02