Transfer Pricing Alert
EY Han Young newsletter
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Transfer Pricing
Current issue.
Republic of Korea,
United Kingdom, Belgium
On 14 April 2016, the Ministry of Strategy and Finance ("MOSF") made an announcement that specially defines which entity may submit the master file in cases where there are more than two entities required to prepare and submit the master file. (Refer to TP Alert issued on May 2016, "No. 2016-007 of Ministry of Strategy and Finance")

On 30 June, 2016, the MOSF made an announcement of the signing of the Multilateral Competent Authority Agreement on the exchange of Country-by-Country Report ("CbC MCAA") in Kyoto, Japan. Yet, the Korean government has not declared legislation of CbCR, but signing of the agreement means that submission requirement of CbCR will happen sooner or later. According to the MOSF, 44 countries can exchange their CbCR from 2018.

Based on the announcement of the MOSF, 31 countries signed the CbC MCAA in January 2016 and 5 more countries joined this agreement including Korea, Curacao, Georgia and Uruguay, bringing the total up to 44 countries. From now on, Korean government plans to actively participate in the implementation of BEPS, and also to cooperate globally in reducing tax avoidance of MNEs. The following table shows the 44 countries which signed the CbC MCAA.

**Korean Government Signed Multilateral Competent Authority Agreement on exchange of Country-by-Country Reports**

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<tr>
<th>OECD Members (30 Countries)</th>
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<tr>
<td>Canada</td>
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<td>New Zealand</td>
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<td>Australia</td>
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<td>Israel</td>
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<td>Austria</td>
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<td>Belgium</td>
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<th>Non-OECD Members (9 Countries)</th>
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<tr>
<td>China</td>
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<td>Costa Rica</td>
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<th>Additionally Joined (5 Countries)</th>
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<td>Argentina</td>
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On 26 May 2016, the UK’s HM Revenue & Customs (HMRC) issued a consultation on the potential introduction of a secondary adjustment rule into the UK’s domestic transfer pricing legislation. Such a rule would be a new rule within the UK’s transfer pricing legislation. Although the UK has not previously sought to introduce such a rule, the issue was highlighted as requiring a watching brief as far back as 1997, in the transfer pricing consultation document of that time.

The UK’s existing transfer pricing rules calculate the taxable profits on the price that would have been charged between people acting at arm’s length. This is achieved via an adjustment (a primary adjustment) to the price that is effective for tax purposes. As the primary adjustment is only effective for tax purposes, a cash benefit from the non-arm’s length pricing can still accumulate. It is this cash benefit that can be targeted and reversed by a secondary adjustment rule, which applies a tax charge on the excess cash arising on non-arm’s length pricing.

This is illustrated by the example in the consultation. Company A is resident in the UK and has paid £10m for products supplied to it by connected overseas Company B. An arm’s-length price is agreed at £8m. The UK’s transfer pricing legislation adjusts the pricing and calculates A’s taxable profits on the basis it only paid £8m for the products. The £2m increase in Company A’s profits (the primary adjustment) does not address the benefit obtained from the retention of that £2m by overseas Company B. Secondary adjustments seek to remove the cash benefit obtained from that £2m retention. The removal of the benefit of the £2m cash retention can be achieved by way of a constructive dividend, equity contribution or loan.

Secondary adjustment rules are a recognized approach in a number of other jurisdictions including the United States and a number of European Union (EU) Member States. The Organization for Economic Co-operation and Development Model Tax Convention never prevents nor requires tax administrations to make secondary adjustments but difficulties can arise in Mutual Agreement Procedures with some jurisdictions not prepared to admit secondary adjustments within the claim and negotiations.

The consultation will be used to help the Government to decide whether to introduce secondary adjustments and if so, on the design of such rules. If the decision is made to introduce the rule, the Government will consider legislating in Finance Bill 2017. The rule is likely to be of most interest to large multinational enterprises but comment is welcomed from all interested parties by 18 August 2016.
United Kingdom

Outline of Proposals

The Government’s preferred approach to secondary adjustments is a deemed loan from the potentially advantaged party (A in the example above) to the disadvantaged party (B in the example above). Interest on the deemed loan would be imputed and would be taxable in the hands of the advantaged party. The paper acknowledges that the issue was considered by the EU Joint Transfer Pricing Forum but does not reference the conclusions reached - being a preference to refrain from making adjustment which lead to double taxation and within the EU, to characterize as dividends or capital contributions rather than loans.

It is proposed that a secondary adjustment would be required whenever a primary adjustment in excess of £1m is required by the transfer pricing rules rather than a notice-led rule aimed at aggressive structures.

The rule could apply to accounting periods after the effective date of the enabling legislation, or the announcement of the legislation. Alternatively, it could apply to open accounting periods on these dates.

The deemed loan should be between the same parties as the provision upon which the primary adjustment arises. The deemed loan would exist for tax purposes only and would not appear in the accounts.

Taxable interest would be imputed on the loan at a pre-set market-adjusted rate, which the consultation document suggests could be set well above the market rate to increase the rule’s deterrent effect.

Secondary adjustments would cease when the excess profits are repatriated to the UK, this being treated as a repayment of the deemed loan.

The deemed loan would start at the end of the accounting period in which the corresponding primary adjustment was made. The deemed loan could be ring fenced to prevent any corresponding tax benefit arising elsewhere as a result. Any corresponding deductions for the imputed interest would depend on the terms of the relevant tax treaty and the mutual agreement procedure.

Secondary adjustments would apply to primary adjustments that arose both inside and outside an Advanced Pricing Agreement.
Belgium to implement formal transfer pricing documentation and country-by-country reporting requirements

The OECD and G20 initiated the BEPS project in 2013.1 On 5 October 2015, the final BEPS package was released, consisting of 15 Actions, based on three core principles: coherence, substance and transparency. One of the cornerstones of the project is the final report on Action 13, Transfer Pricing Documentation and Country-by-Country Reporting (CbCR) which aims at providing tax administrations with relevant information to conduct transfer pricing risk assessment analyses and audits of transfer pricing practices. This report contains guidance on transfer pricing documentation. It also includes a template and model legislation for CbCR.

The Belgian Federal Government now intends to implement these principles into Belgian legislation. This Alert summarizes the most relevant aspects of this proposed new legislation.

**Upcoming Belgian legislation**

The upcoming legislation on transfer pricing documentation implements the OECD's model legislation into the Belgian income tax law, implementing the three-tiered approach for transfer pricing documentation consisting of CbCR, the Master File, and the Local File. These rules will be included in Articles 321/1 – 321/7 of the Belgian Tax Income Code 1992 (BITC 92).

**CbC reporting**

The CbCR should contain the following information for each country where entities of the Group operate: gross income, profit/loss before tax, income tax paid, accrued income tax, the nature of the group entities' core business operations, and other measures of economic activity. In addition, the main business activities of all entities in each country should be disclosed.

For Belgium, if the ultimate parent company of a multinational enterprise (MNE) group with a consolidated annual group turnover equal to or exceeding €750 million is a Belgian tax resident, the entity must prepare and submit a CbCR form to Belgian tax authorities within 12 months as of the last day of the financial year. To ensure that the Belgian tax authorities have access to this CbCR form, a Belgian group entity that is not the ultimate parent company of the MNE group should also file a CbCR form with the Belgian tax authorities in one of the following cases:
Belgium

- The ultimate parent company is not obliged to submit a CbCR form in its country of residence.
- The ultimate parent company is obliged to submit a CbCR form, but there is no automatic exchange of CbCR between Belgium and the country of residence of the ultimate parent company.
- The ultimate parent company is obliged to submit a CbCR form, and there is automatic exchange of CbCR, but due to systematic failure, no effective exchange of information takes place.

In these three cases, a group can decide to appoint a so-called surrogate parent entity to comply with these requirements. A Belgian group entity will need to notify the Belgian tax authorities, whether it is the ultimate or surrogate group company, or, in case it is not, the identity of the ultimate or surrogate group entity (including the identification of its tax residency).

The information contained in the CbCR will be automatically exchanged with EU Member States or other concerned tax authorities according to the stipulations provided by the relevant international instruments (Multilateral Convention on Administrative Assistance in Tax Matters, Bilateral tax conventions, or Tax Information Exchange Agreements).

The CbCR should be prepared on a specific form in one of the Belgian official languages, or in English (considering that a translation might be requested).

**Transfer pricing documentation**

Every qualifying Belgian group entity that is member of an MNE group will be required to prepare a master file and a local file when one of following criteria is exceeded in its statutory financial accounts in the prior year:

- Gross operating and financial income equal to or exceeding €50 million (excluding non-recurring items)
- Balance sheet total equal to or exceeding €1 billion
- Average annual number of employees of 100 in full time equivalents

The Master File should contain an overview of the MNE group, including the nature of its business operations, its intangible assets, the intercompany financial activities, consolidated financial and tax position of the group, transfer pricing policy and worldwide allocation of income and economic activities. The Master File should be submitted to the Belgian tax authorities within 12 months after the end of the financial year. It is expected that this will be applicable as of financial years starting on or after 1 January
2016. The form of the Master File will be determined by Royal Decree.
The Local File should list general information on the local entity.

In addition, a detailed form will be requested that contains transaction specific information, information on the transfer pricing analyses, comparability studies, etc. This detailed form will only be required for the business units of the Belgian entity of which the cross border transactions exceed an amount of €1 million in the last accounting year. The definition of “business unit” still needs to be clarified. The exact content of these forms is still being reviewed.

The Local File should be submitted with the tax return. It is expected that this obligation will be applicable for financial years starting on or after 1 January 2016.

Other considerations
Failure to submit the CbCR form, Master File or Local File will result in an administrative penalty ranging from €1,250 to €25,000. This penalty will apply as of the second infringement. Furthermore, non-compliance with the new transfer pricing documentation obligations is likely to increase the audit risk.

Belgian tax resident entities that are part of an MNE group and meet the financial thresholds will need to comply with the CbCR and TP documentation requirements for financial years starting on or after 1 January 2016. Although some of the information will likely be requested in specific standardized forms, the implementation of transfer pricing requirements is generally in line with the standardized three-tiered approach defined by the OECD. Considering the tight deadlines, MNEs with a presence in Belgium should take immediate action in order to make sure their transfer pricing policies are properly documented and properly implemented. Before year-end, Belgian group entities should file a notification with the Belgian tax authorities to indicate which group entity will be responsible for filing the CbCR form.

The increased transparency and audit capacity of the Belgian tax authorities, in combination with the changes in transfer pricing rules as a result of BEPS Actions 8-10, will likely increase the attention to transfer pricing issues. MNEs should review their transfer pricing policies and identify areas for improvement and mitigation of transfer pricing risks.
Contacts

Transfer Pricing

Sang Min Ahn
Partner
02.3787.4602
Sang-min.ahn@kr.ey.com

Sung Han Park
Partner
02.3787.6355
Won-bo.jung@kr.ey.com

Dong Hoon Ha
Partner
02.3770.0936
Dong-hoon Ha@kr.ey.com

Hoon Seok Chung
Director
02.3770.0924
Hoonseok.chung@kr.ey.com

Jae Seong Yun
Director
02.3787.4265
Jae-seong.yun@kr.ey.com

Ki Se Kim
Senior Manager
02.3770.0918
Ki-se.kim@kr.ey.com

Kyoung Bae Han
Director (Vietnam, Ho Chi Minh)
+84 8 3824 5252 (ext. 8305)
kyoung.bae.han@vn.ey.com

Transfer Pricing-
Financial Services
Organization (FSO)

Stella Kim
Director
02.3770.0980
Stella.kim@kr.ey.com

Business Tax Service

Min Yong Kwon
Partner
02.3770.0934
Min-yong.kwon@kr.ey.com

Dong Chul Kim
Partner
02.3770.0903
Dong-chul.kim@kr.ey.com

Jae Cheol Kim
Partner
02.3770.0961
Jae-cheol.kim@kr.ey.com

Young Ro Bae
Executive Director
02.3770.0936
sunghan.park@kr.ey.com

Song Min Oh
Executive Director
02.3770.0983
Song-min.oh@kr.ey.com

International Tax
Service

Jaewon Lee
Partner
02.3787.4601
Jaewon.lee@kr.ey.com

Kyung Tae Ko
Partner
02.3770.0921
Kyung-tae.ko@kr.ey.com

Yeon Ki Ko
Partner
02.3787.4637
Yeonki.Ko@kr.ey.com

Nam Wun Jang
Partner
02.3787.4539
Nam-Wun.Jang@kr.ey.com

Financial Services
Organization

Jong Yeol Park
Partner
02.3770.0904
Jong-yeol.park@kr.ey.com

Jeong Hun You
Partner
02.3770.0972
Jeong-hun.you@kr.ey.com

Dong Sung Kim
Partner
02.3787.4238
Dong-sung.kim@kr.ey.com

Human Capital

Danielle Suh
Partner
02.3770.0902
Danielle.suh@kr.ey.com

Min Ah Kim
Executive Director
02.3770.1019
Min-ah.kim@kr.ey.com

Transaction Tax

Jin Hyun Seok
Partner
02.3770.0932
Jin-hyun.seok@kr.ey.com