

NEWSLETTER

IFA ~ INDIA BRANCH



Mukesh Butani
Chairman, India branch

Dear IFA Colleagues & Friends,

I trust this mail finds you in good spirit with the past few day's optimism on GDP growth figures and the arrival of vaccine, not to forget the historical heights of indices! I hope you all are hanging in

as we get closer to a solution, hopefully.

First, I wish to place on record IFA's gratitude for contributions made by our treasurer Late Amar

Mittal who we lost . Some of you may perhaps have known him as an EC member, but, I have seen his commitment past three decades for the IFA cause and how he has single handedly been managing the administration of IFA's Noida academy besides the treasury function for the branch. I recall my last conversation as late as June when I approached him for slowing down the Noida refurbishment work due to shortage of funds and his immediate answer was that we need not and that he would expedite processing of tax refunds, which he immediately delivered. He was an IFA Pillar and "Go to" person

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we shall immensely miss.

The November/ December newsletter curated by Praveen Ranka and Hasnain Shroff with a star-studded Indian & international panel discusses the importance of Transfer Pricing in the context of Covid, a topic we dedicated in the June virtual event. It's for you to digest the rich contents of the case study, rendered in the context of manufacturing supply-chain disruption and consequent TP challenges. What did catch to my attention was an important and urgent need for multilateral forums like the OECD, what would be an extra-ordinary business circumstance and stresses upon the law makers to issue guidance in times of what the authors have labelled as 'health & humanitarian crises' well beyond the 'financial crises' of 2008. It also questions the validity of assumptions under force majeure obligations as well as the principles of 'extra-ordinary' expenses & use of "multiple-year" data in economic analysis. I trust the law makers take note of them and navigate changes to lend certainty to taxpayers.

Colleagues, we had an outstanding IFA virtual conference starting on Diwali and I trust you enjoyed richness of the technical contents. Though, a poor substitute to the Cancun Congress, I guess it was an

appropriate way to make use of enormous research that went into publishing the General & branch reports, which I am sure will serve as useful addition to the library of the members.

I wish to take this opportunity to Congratulate Kuntal Dave for being nominated as the Chairman for IFA Asia Chapter, Parul Jain for being nominated as India representative of WIN in the global IFA and her deputy Karishma Phatarphekar. The elevation of our members in the Global IFA organizations peaks volumes of the depth of experience and leadership that India branch can contribute to. We also seized the auspicious Diwali opportunity to launch our swanky Academy at the Bandra-Kurla complex, from where we live streamed some of the virtual conference sessions. Without efforts of the members of IFA 2014 Congress in Mumbai, we would not have been able to build this infrastructure, which will serve as a second center for tax research.

Wish you all good health and hope that by the time, we reach our next quarterly edition, we are back to normalcy. In the meantime, Merry Christmas and greetings for the new year, in advance as we emerge from a year better forgotten.

Sincerely, Mukesh



Paresh Parekh
Editor-in-chief

Dear Readers,

A warm welcome to our ninth edition of the IFA India newsletter. Hopefully you are back to office / home office, post festive break and now reading the copy of this newsletter with rejuvenated minds.

The newsletter opens with a practical case study dealing with the impact of the COVID-19 pandemic on transfer pricing analysis conceptualized. We are privileged to obtain views on the case study from some of the leading transfer pricing experts. This is followed by coverage of key international tax updates. As

most of us are working virtually, we have provided a glimpse of the various past and forthcoming IFA events which have been organized by IFA in webinar format. Also, I personally thank our leading experts for indispensable contribution and our avid readers encouraging us to publish new technical material and content every quarter.

I would encourage each one of you to share with me or any of the Editorial team member [write to 'info@ifaindiaacademy.in'], more ideas on what differently should or can be done in the future issues of Newsletter to keep adding value and deliver excellence to fellow professionals.

In the meantime, Happy Reading and Happy Festive Season!

Paresh Parekh

CASE STUDY, QUESTIONS & EXPERTSPEAK

COVID IMPACT ON TP ANALYSIS - TREATMENT OF EXPENSES

Contributed by:

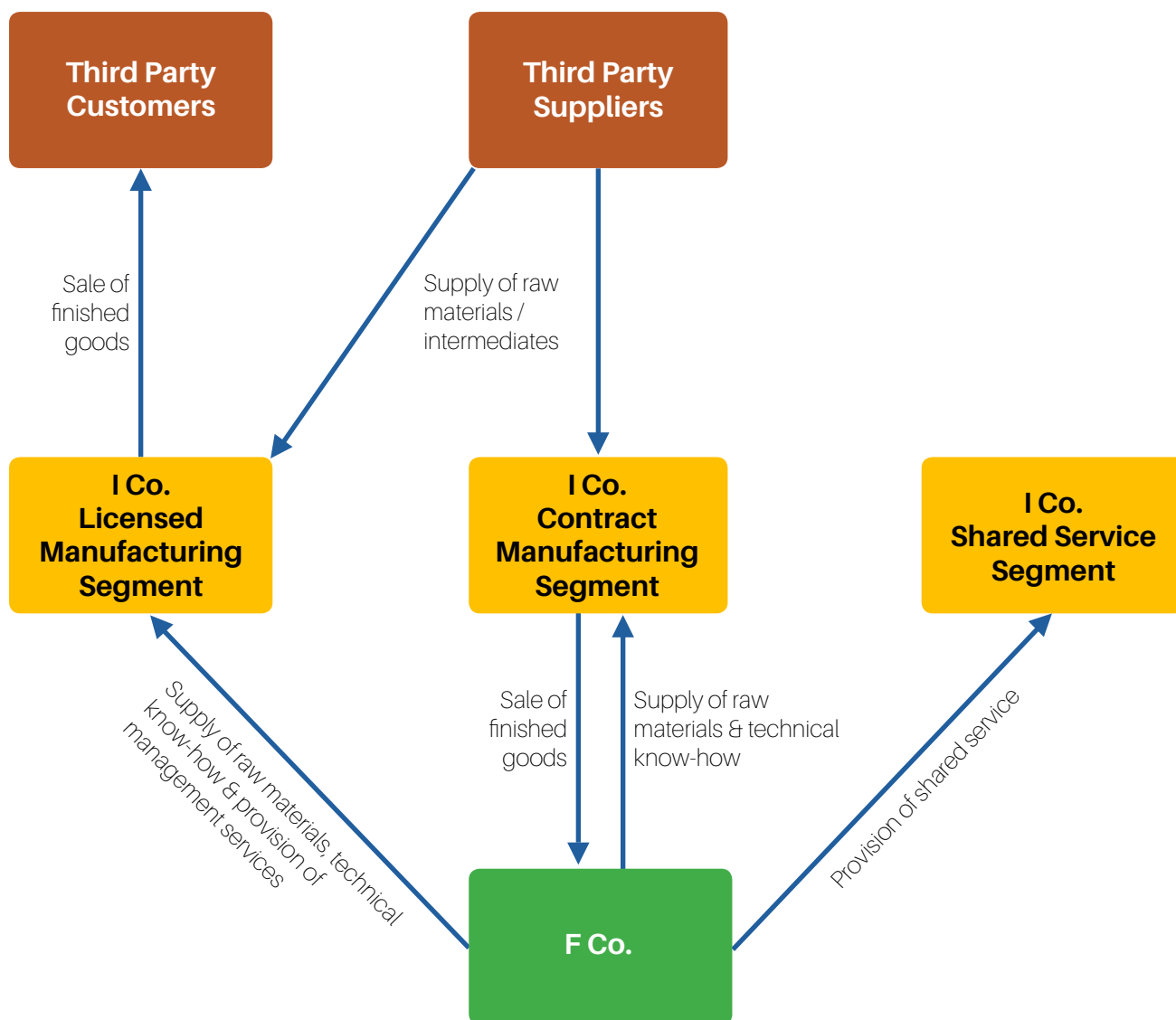
Praveen Ranka and Hasnain Shroff

BACKGROUND

The impact of COVID-19 pandemic is felt across all industries especially the manufacturing sector that has experienced major supply chain and demand side disruption. Further in case of limited risk service providers, the business volumes have dropped for captives in several industries. Accordingly, there is a need for MNEs to revisit the transfer pricing policy and defense strategy. This case study tries to capture some of the practical transfer pricing issues faced by most manufacturers and service providers in the current times.

FACTS OF THE CASE

I Co. is a wholly owned subsidiary of F Co. having three business segments namely – a) manufacture and sale to third parties in domestic market ('licensed manufacturing' segment), b) manufacture and sale to group entities ('contracting manufacturing' segment) and c) captive shared services segment (captive services segment). F Co. owns the technology/know-how in respect of the products and processes involved in the manufacturing operations.



In the manufacturing segments, raw materials are predominantly imported from related and unrelated parties. In the licensed manufacturing segment, the company is responsible for marketing and distribution in the local market. In the contract manufacturing segment, the company is remunerated on a standard cost-plus mark-up basis, and in the captive services segment, it is remunerated on a full cost-plus mark-up. Further, F Co. charges royalty for the technology provided and also centrally provides management services functions in relation to strategy, IT, HR, purchasing and accounting, etc. across all Group entities including I Co. and allocates expenses to each group entity based on their external sales.

Historically, TNMM has been adopted as the most appropriate method for all three activities, with I Co.'s respective segments as tested party.

The pandemic has adversely impacted the Group both in local and global markets, disrupting the supply chain as well as demand. The global revenues are estimated to be reduced by 30%, resulting in significant losses at a net level. The volumes in the shared services segment have also significantly dropped due to lower economic activity, while F Co. has spent considerable additional time in various functions.

QUESTIONS & EXPERTS SPEAK



HITESH GAJARIA
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1. In the captive service segment, I Co. has incurred significant idle cost due to lower volumes and additional expenses have been incurred to create WFH infrastructure. What options does I Co. have with respect to these expenses and the mark-up while billing to its AEs? Which clauses in the inter-company services agreement should be considered to reflect the role of parties and the revised pricing model in this distressed situation?

HG: At the outset, it is relevant to state that the effect of the pandemic on businesses is varied across industries and companies within the same industry. Thus, each situation shall require thorough analysis of the facts and circumstances and there can be no one-size-fits-all kind of solution.

In determining remuneration between two parties, there are two key considerations

i.e. i) the functions performed and who controls/bears the risks, and ii) the contractual arrangement for such transactions, between the parties. A captive service provider, remunerated on an assured arm's length returns, typically performs routine activities as directed by its principal, and does not control or bear significant business risks.

A captive service provider may have idle capacity broadly in two situations – A) service provider is available to perform its obligations under the contract but no work has been assigned to it, or B) work has been assigned, but the service provider is not able to deliver that work due to various reasons – either due to force majeure events or reasons which were within reasonable control of the service provider or any other event. The aforesaid situation of idle capacity in I Co's captive service segment seems to have characteristics of both A and B above.

Situation A - To the extent, I Co was available to perform its contractual obligations but there was reduction in volumes from F Co, it can be said that such risk was beyond the control of I Co. and hence I Co. should not bear any risk or loss on such account. However, it is important to evaluate what options are realistically available with an unrelated entity in similar circumstances. Usually limited-risk contractual relationships are not enforced on a permanent basis in extra-ordinary situations such as this one, and sustenance of the businesses are based on decisions keeping in mind the long-lasting business relationship.

As response to falling volumes, there is an option to reduce I Co.'s headcount or fixed costs proportionate to the lower volumes to avoid losses. It is important to analyze the rationale and circumstance in which such decisions are made (whether to retrench employees or not) and whether I Co. has the power to make such decisions. The pandemic seems to be having an adverse impact for a longer term in some business (e.g. in airlines, hospitality, retail, travel, theatres, etc.) while in some other industries the impact may be perceived to be of a shorter term in nature. Since it is difficult to reasonably predict the length of the disruption, a prudent third party may postpone the down-sizing decision until there is some visibility. Also, an unrelated party may decide to bear short term losses to capitalize when there is a rebound, since down-sizing and re-hiring are expensive exercises. Further, restrictions imposed by local government and labor unions preventing companies from down-sizing, may also be a relevant factor. After all, it can be argued that limited risk entities, as separate going concerns, are not entirely risk-free and are subject to some form of risks relating to performance of services as contractually agreed. This will depend on the facts and circumstances of the case.

Where I Co. decides to bear some of these costs by not charging the principal or

by charging an amount which is lower than what is contractually agreed, it is likely that the tax authorities may challenge such a position given the characterization of I Co. as bearing limited risk. Thus, it becomes important to contemporaneously document the basis and outcome of the decisions made in this regard. Also, I Co. should proactively review the impact of such position in future as soon as the adverse effects of the pandemic recede.

Situation B - In any third-party situation, a party shall not be willing to pay if there have been no services received. Thus, in a situation where the captive service provider was unable to render services due to factors beyond the control of the Principal, and has incurred idle capacity costs, a position can be taken that such costs are not required to be reimbursed.

The UN TP guidelines¹ discuss the need to analyze operational and political risks of operating in a particular country wherein entities are affected by events beyond a business's control. Such risk is typically borne by the entity situated in such country. These are considered extra-ordinary or force majeure events and the costs relating to such events can be considered as extra-ordinary costs.

It is important to document and demonstrate "extra-ordinary" business circumstances or costs by displaying tested party's data over a period to simulate normal conditions and to explain the unusual variations. In arriving at such extraordinary costs, due consideration should also be given to savings in costs on account of work-from-home scenario. This includes, but is not limited to, savings in office maintenance costs, employee travel expenses, staff welfare costs, renegotiated fixed costs, rent and related costs on account of giving up office space, lower salary increments / bonus etc.

To enable such adjustment, the contractual agreement between the parties must include a clause to exclude extra-ordinary costs from the cost base for the purposes of arriving at

mark-up. Exclusion of extra-ordinary costs from the cost base is common in most inter-company agreements, is supported by judicial precedents and safe harbor rules and also forms part of many APAs signed with Indian Tax Authorities.

This should further be supplemented by clear definition of force majeure events, and the rights and responsibilities of the parties in such events. Typically, the parties agree for the agreement to be suspended during such force majeure events. In addition, as mentioned above, the decisions undertaken and consideration of third-party behavior in making such decisions should be clearly and contemporaneously documented. Qualitative and quantitative disclosure of the impact as part of directors' report and annual report can also be evaluated.

VI: First part of the Question

For TNMM analysis, it will be imperative to analyse if the significant idle costs / additional expenses incurred by the ICo. are specific to ICo. or have been incurred by the industry (as a whole) within which ICo. operates. If such costs have been incurred by the overall industry then such costs will form part of the costs incurred by the comparables also. Additionally, while tested party (ICo.) may identify such costs for itself but such details / data points may not be available in the financial data of the comparables available in the public domain. Hence, such costs should be treated as operating item and ICo. should charge a mark-up on such costs. However, a lower mark-up (35th percentile of the comparable data points) can be agreed for temporary period.

However, if such costs are specific to ICo. only and not for the industry, such extraordinary costs can be considered non-operating items and thus not included in the cost base which on ICo. gets compensated. Extraordinary expenses are those expenses which are non-recurring expenses in nature, not related to

normal operations of the taxpayer and which are likely to materially affect price/profit in open market. In the present case, where such costs are incurred solely by ICo. are clearly beyond normal business circumstances / industry performance.

Second Part of the Question

OECD TP Guidelines 2017 suggest that any inter-company agreement between group companies should only be a starting point for undertaking functional analysis & allocation of risks amongst group entities as divergence of interests may not exist in the case of group companies or any such divergences may be managed in ways facilitated by the control relationship and not solely or mainly through contractual agreements. It is, therefore, particularly important in considering the commercial or financial relations between group companies to examine whether the arrangements reflected in the actual conduct of the parties substantially conform to the terms of any written contract, or whether the group companies' actual conduct indicates that the contractual terms have not been followed, do not reflect a complete picture of the transactions. Where there are material differences between contractual terms and the conduct of the group companies in their relations with one another, the functions they actually perform, the assets they actually use, and the risks they actually assume, considered in the context of the contractual terms, should ultimately determine the factual substance and accurately delineate the actual transaction.²

However, the Indian courts, tax officers or any legal forum expect a transparent inter-company agreement wherein the roles & responsibilities of the transacting parties are clearly defined. Hence, the key clauses wherein roles, responsibilities and obligations of the both the parties are defined should be reconsidered / evaluated while deciding on how to treat these expenses. 'Force Majeure'

is also included in several inter-company agreements which can be relied upon to give effect to such extra-ordinary items.

GCC: In assessing the transfer pricing of MNEs during the COVID-19-related crisis, the ALP should be observed. While it would be beneficial to have further guidance on how to deal at arm's length in times of crisis, the ALP is no stranger to situations of economic downturns and has emerged victorious from previous challenges.³ However, this crisis is different in many aspects than, e.g., the 2008 financial crisis and consequently presents different challenges for both taxpayers and tax administrations. The current crisis is not only an economic crisis, but a health crisis and a humanitarian crisis affecting almost all countries. It has brought sudden disruption to businesses and people's life and has had an enormous impact on human behaviour, including consumer habits, digital transformation, and working from home requirements. Nevertheless, in times of unprecedented uncertainty, lessons can be drawn from how the ALP has been applied in previous crisis.

While transfer pricing policy should be kept as consistent as possible, there is a need for business continuity as many companies, including the group in the facts of the case, have incurred losses. In the case of I Co., in particular, it has incurred significant idle cost in the captive service segment due to lower volumes of services provided and additional expenses to create a WFH structure. In line with the ALP, an accurate delineation of the actual transaction (with specific focus on functional analysis and economic characteristics) should be performed to determine whether I Co. can pass on those expenses to F Co. and whether there must be a change in pricing of the services and on intercompany agreements.

The COVID-19-related crisis has put pressure on the remuneration and

characterization of limited risk entities. It is important to note that limited risk entities still carry some level of risk, e.g. operational risks, and that exceptional risks may not have been foreseen by the group when delineating the functional and risk profile of entities.

It should be analyzed which entity takes important decisions related to risk mitigation and, in particular, in deciding the structure involved in WFH. F Co. provides management services to the captive segment of I Co., including on IT and on strategy. It can be assumed that F Co. plays a strategic role in the important decisions related to crisis response and creating a WFH infrastructure. In such case, these expenses can be passed on to F Co. However, if in reality I Co. played an important decision-making role in this regard (as opposed to merely following instructions from F Co.), then it has to assume part of the expenses in proportion to its functions performed, assets used and risks assumed. In the latter case, if it is found that I Co. is taking significantly higher risks than its functional profile as a limited risk entity, then the accurate delineation of the actual transaction should be changed accordingly and I Co. should demonstrate that it also has financial capacity to assume the risks. As such, contractual risk allocation should follow the OECD's six-step approach.⁴ However, a detailed analysis of the nature of the specific costs charged and on whether those costs can be charged, in line with the benefit test⁵, should be performed and accurately documented.

As for the mark-up on the costs, shared services are typically considered low value-adding services and charged with a low mark-up on cost. Given the low value-adding nature of the services, it may be difficult to justify a higher mark-up as third parties would be willing to provide the same services for a lower price. I Co. could either make use of a safe harbour on low value-adding services, if available in I Co.'s jurisdiction, or perform a benchmarking

analysis to find the arm's length mark-up used by comparable unrelated entities (see question 2 below). Since the group is in a loss position, it could be justifiable to charge the services without a mark-up if that is allowed in I Co.'s jurisdiction. Charging without a mark-up may be a better option for I Co. than to risk the AEs going out of business. Care should be taken to prevent abusive situations and thus an options realistically available analysis should be performed. The bargaining power of the parties to the transaction should also be considered when determining whether the higher idle costs and additional expenses (if retained, at least in part, by I Co.) can be passed on to the AEs.

Important to note is that intercompany agreements are legally binding and the parties cannot be exempt from their contractual obligations (except on the case of force majeure, if applicable⁶, where the contract can be unilaterally terminated or substantially modified under exceptional circumstances not controlled by the parties). However, they may need to be changed if there is a significant change in the relevant economic characteristics (incl. functional and risk profile) of the transactions and this change is not only of a temporary nature. In assessing whether intercompany agreements need to be changed to reflect the new reality, one should analyze what third parties would do under similar circumstances. Indeed, third parties may accept a change in the contractual terms because the next option realistically available to them (e.g. to terminate the contract and either perform the services in-house or find a new services provider) may be more burdensome or not possible. In the case at hand, there could be a change on payment terms to reflect a new pricing structure and on delivery terms to account for services being now delivered in an online format. There could also be a change on supply volume (if previously determined in

the agreement) as I Co.'s demand for services from AEs have declined due to the economic circumstances. Moreover, as mentioned above, if it is found that I Co. is in reality performing more functions and assuming more risks than its contractually allocated, also this should be reflected in an amended intercompany agreement and proper capital should be allocated to ensure I Co. has financial capacity to assume the risks.

Finally, the group should also consider other potential implications⁷ of WFH, e.g. the creation of PEs if the employees work from abroad and other tax treaty implications, and regulatory and labour law issues.

2) What factors should be considered while performing the comparability analysis for the captive segment?

HG: Considering the widespread impact of the pandemic, demonstrating the extraordinary impact only on the tested party is a complicated exercise. Unfortunately, even if current financial data is available, detailed financial data of comparables reflecting the pandemic effects on capacity utilized or additional costs are difficult to obtain. In such a scenario, the comparable companies used for testing the ALP become pivotal. The comparables may also be experiencing adverse (or favorable) effects from current economic conditions, which can affect their profitability as well as their very comparability to the tested party.

Where it appears that the results of the traditional comparables selected year-on-year may differ from the tested party, the comparable search strategy may have to be revisited. Also, it will be important to identify ways in which the comparables' situations differ from those of the tested party; such as severity of impact, regional variations, ability to react, etc. The effects on working capital also must be considered.

Companies with the same services profile may have varying impact based on the extent of pandemic impact to business of their customers. For instance, the impact can vary between a back-office service provider having customers in retail or travel industries and a back-office service provider whose customers are in industries where the pandemic impact is considerably lower. Thus, the comparables may be functionally similar but with varying degrees of impact, whereas the competitors may not be comparables due to different reasons.

New quantitative and qualitative filters may need to be included to reflect the economic situation. An often-discussed issue is whether it is appropriate to include loss-making companies in the comparables set, or to at least relax the screening criteria that tend to exclude poorly performing companies. Additional filters may be applied to identify companies having similar trend of fall in sales like I Co. or who have witnessed fall in margins during relevant tested financial period. Given the unique nature of this downturn coupled with limited comparable data available, locating a taxpayer-similar pattern to make a specific adjustment may be quite challenging. Data from interim financial results of comparable listed entities or various industry reports may be useful in performing this analysis.

The Indian transfer pricing rules mandatorily require a single year's financial results of the tested party be compared to 3-year results of comparable companies. Typically, use of multiple year averages are intended to reduce the effect of short-term variations that may be unrelated to transfer pricing. Comparison of I Co.'s single year results that are impacted by the pandemic with mandatory use of multiple year data of the comparables would lead to distorted results. Where it can be demonstrated that single year margins of comparables reflect a

higher degree of comparability, the taxpayer may adopt the same. This position is likely to be challenged by the tax authorities at the lower level.

Depending on the quality of comparables selected, the company may target to maintain margins within the arm's length range. If the adverse impact on tested party's business is more severe than the impact on comparables, the taxpayer can target to achieve margins lower than the median but within the arm's length range. ...

As deliberated above, the degree of subjectivity in comparability analysis is high and there is no single solution that fits all circumstances. Hence, comparability analysis needs to be revisited for each circumstance and be tailored for specific facts. Also, the degree and basis of comparability would need to be properly explained.

VI: Few factors which can be considered are (only illustrative):

- Financial impact of COVID-19 pandemic on tested party's / group's business vis-à-vis impact of pandemic on the sector / industry in which tested party / group operate
- While Rule 10B and Rule 10CA of the Income Tax Rules' 1962 provide for use of multiple year data but caution should be taken while comparing tested party's result (for FY 2020-21 which will be pandemic hit) vs past years' data of comparable (which will reflect returns under normal business circumstances)
- Any extra-ordinary expenses / grants reported by comparables due to pandemic impact should be carefully analysed vis-à-vis the tested party before treating them as operating / non-operating in nature
- Relaxation of quantitative filters (related to losses / networth / financial sickness) can also be evaluated while identifying comparables

- Comparability adjustment for COVID-19 pandemic impact can be undertaken by arriving at adjustment factor through a comparison of financial results of comparable companies (eg. Q1 FY 2020-21 vs Q1 results of FY 19-20)
- Comparability adjustment for COVID-19 pandemic impact can be undertaken by arriving at an adjustment factor of impact on financial results of comparable companies during past economic crisis (eg. 2008 financial crisis)

GCC: Comparability analysis is at the core of the ALP and can be particularly challenging at current times. As a starting point, the OECD's nine-step process can be used as guidance, although the actual conduct of the comparability analysis will depend on the facts and circumstances of the case.⁸

In the case of I Co.'s captive segment, the shared services are typically considered low value-adding services, for which a simplified approach in line with the low value-adding services guidance provided by the OECD⁹ may apply. If that is not the case, I Co. needs to perform the comparability analysis for the captive segment and may face difficulties in finding reliable comparables, as contemporaneous comparables may not be available and comparables from previous years may be outdated and not reflect the current economic circumstances. Indeed, the use of benchmarking databases may not be helpful, as 2020 financial data may only be available at the end of 2021 or in 2022. This is an important issue as a year-end adjustment may not be available in I Co.'s jurisdiction or an ex-post adjustment may have indirect taxes or customs duties implications. Regarding the lack of comparables, the toolkit prepared by the Platform for Collaboration on Tax contains useful guidance.¹⁰ Moreover, I Co. could select different target ranges, different

years covered, or perform comparability adjustments to the tested party or to the selected comparables.¹¹

Finally, lessons can be drawn from the 2008 financial crisis regarding comparability adjustments. Adjustments to financial profitability (e.g. regression-type analyses or cost structure analyses) can be performed to account for a decline on demand. Moreover, if intercompany agreements are amended, an adjustment for contractual and payment terms may be required. Other options may be to use financial data from the 2008 financial crisis, 2020 public company data (if available), and microeconomic or macroeconomic data.¹²

3) Due to lockdown situation, the existing suppliers have not been able to cater to Company's requirement, forcing the Company to look for alternate supply sources. The price of these components from alternate suppliers is significantly higher compared to the existing suppliers and was not factored in computing the standard cost. In addition, there have been significant rejections and returns from AEs due to quality issues arising due to sub-standard quality of products purchased from alternate suppliers. Can I Co. pass on these higher input cost and rejection cost to F Co.?

HG: The contractual allocation of functions and risks relating to procurement and quality control has a crucial role in determining the characterization and remuneration of a contract manufacturer. In a typical contract manufacturing arrangement, the Principal provides the technology and the market for the goods produced by the contract manufacturer. The degree of control that a contract manufacturer exercises on the procurement and quality control functions varies between industries and is also

dependent on how centralized is the MNE Group's supply chain. It is important to accurately delineate the ex-ante allocation of functions and risks relating to procurement and quality control activities and which entities shall bear the loss in case the risks are materialized.

In the given situation, I Co. has suffered losses on account of sub-standard quality of supplies from alternate sources and consequent rejection and returns. In case, the decisions relating to quality and procurement are clearly defined and dictated by F Co., the costs incurred on account of sub-standard quality and rejections should be borne by F Co. It is important to analyze if the trigger to pursue alternate suppliers arises from circumstances which were within or beyond the control of either parties, or which party undertook major decisions in this regard.

Typically, where an entity is remunerated on a standard cost-plus basis, the profit / loss arising on account of variance between the standard and actual costs is retained by the contract manufacturer. This incentivizes the contract manufacturer to bring in efficiencies in the manufacturing process. Accordingly, a customer may not be willing to pay for variances arising on account of bottlenecks which are under reasonable control of the contract manufacturer. Further, as discussed in response to Q.no.1 above, the risks relating to operating in a particular country is typically borne by the entity situated in such country.

The pandemic has caused supply bottlenecks and forced revamp of supply chains resulting in sales returns, inventory write-offs, additional freight costs in air-lifting critical material and the like.

Based on the functional analysis, I Co. has the option either to i) bear the additional costs and claim extra-ordinary costs adjustment in computing the tested party's margins, or ii) receive cost to cost reimbursement for such costs. Documentation shall be the key to

substantiate the position adopted during a transfer pricing audit.

VI: For TNMM analysis, it will be imperative to analyse if such costs incurred by the ICo. are specific to ICo. or have been incurred by the overall industry within which ICo. operates. If such costs have been incurred by the overall industry then such costs will form part of the costs incurred by the comparables also. Additionally, while tested party (ICo.) may identify such costs for itself but such details / data points may not be available in the financial data of the comparables available in the public domain. Hence, such costs should be treated as operating item and ICo. should charge a mark-up on such costs. However, a lower mark-up (35th percentile of the comparable data points) can be agreed for a temporary period. Even though, for contract manufacturing segment, ICo. is guaranteed a mark-up on standard costs only, an annual true-up / true-down adjustment should be made to ensure ICo. gets compensated on arm's length margin over its overall operating costs (and not merely standard costs). Alternatively, basis ICo.'s business projections, FCo. and ICo. can agree that ICo. will earn arm's length margin over a fixed period (say 3-5 years) and hence any loss / lower margin earned by ICo. during any year will be offset with a higher compensation in future and thereby ICo. is assured of a guaranteed arm's length return over such agreed period.

In case of the licensed manufacturing segment, with an assumption that ICo. can be characterized as an entrepreneurial entity, such costs cannot be crossed charged by ICo. to FCo. (with or without mark-up). However, while determining operating profitability of ICo. from these operations, any extra-ordinary costs (including these costs) due to pandemic impact can be argued to be considered as extra-ordinary costs for the tested party and hence treated as non-operating in nature.

In case of losses suffered by ICo. for the licensed manufacturing segment, it should be minutely analysed to ascertain which of the participating entities (ICo. and FCo.) are performing the key risk controlling functions and controlling the economically significant risks. If such analysis confirms that only ICo. is performing the key risk controlling functions and assuming all the economically significant risks then it may not be appropriate to choose ICo. as the tested party for this segment and FCo. should be selected, instead of ICo., as the tested party for the TNMM analysis. However, if the analysis confirms that ICo. and FCo. jointly performing the key risk controlling functions and assuming all the economically significant risks, Profit Split Method should be selected to split the profits / losses arising from such business.

GCC: F Co. provides management services functions in relation to strategy and purchasing services to I Co. It is assumed that F Co. is responsible for key decisions related to purchasing functions, such as the choice of the supplier and ensuring that the supplier provides a reasonable purchasing price and a standard product quality. Assuming I Co. does not have the power to choose a supplier apart from a pre-approved list of suppliers provided by F Co., this risk should be allocated to F Co. only. Accordingly, F Co. should bear the higher input costs.

Moreover, it is not clear from the facts who performs a quality control both in the choice of the supplier of the components and of the manufacturing process (although it is said that F Co. provides the know-how for the manufacturing process). Similar to the higher input cost, the rejection cost also should be passed on to F Co. as it provides purchasing management services to I Co. This assumes that I Co. has no decision power related to the choice of supplier and cannot reject

the supplied components based on quality control without consulting F Co.

4) I Co. does not have committed/ guaranteed capacity offtake from its AEs. The sale price arrived by using standard cost pricing methodology computed on a per-piece basis historically resulted in arm's length margins in the contract manufacturing segment. The pandemic has resulted in loss of demand in both the manufacturing segments, leading to significant idle capacity cost. What factors should be considered in revising the sale price to AEs, allocating idle capacity cost and in preparing the segmented financials?

HG: There are many companies with manufacturing segments catering to third party customers as well as AE customers. In some cases, there is a guaranteed offtake of capacity from AEs whereas many times, the manufacturer retains the right to use the available capacity to capitalize on increased demand in the third-party segment and earn higher entrepreneurial profits. In such cases, the standard costs are typically determined based on reasonable estimate of capacity utilization and spreading the fixed manufacturing overheads over the number of units projected to be manufactured. If there is higher production and sale to either customer in a year, the manufacturer is rewarded with higher profits.

However, in a year such as this, where the capacity utilization is lower than projections, the pertinent question which such manufacturers face at the time of setting prices and while preparing segmented financials is how to allocate idle capacity costs between the two segments.

In a real-life third-party negotiation, where there is no guaranteed offtake, buyers will be seldom willing to bear the idle capacity costs of seller, especially in the given scenario of

F Co. also being significantly affected by the pandemic.

Thus, in determining the transfer prices, I Co. may consider the sale prices it is able to command from third party customers and make adjustments to these to reflect the lesser efforts in sales and other functions and lower risks borne in the contract manufacturing segment. For year end testing of margins, such idle capacity costs can be considered extraordinary and excluded from computation of PLI. I Co. would need to consider the potential comparison with prices and margins earned in the licensed manufacturing segment.

Tax authorities are likely to allege that the I Co. should recover the costs to the extent capacity has been historically utilized by F Co., especially if some significant expansion or investment had been made keeping in mind demand expected from the AE.

Considering the subjective and litigative nature of these positions, taxpayers must maintain robust documentation to substantiate the basis and rationale of the analysis performed.

VI: Revising Sale Price

For contract manufacturing segment, I Co. can look to charge on full cost plus mark-up basis instead of standard costing. The same can be implemented as (i) Continue charging monthly / quarterly basis standard costs; (ii) Issue invoice / debit note at the end of the year to ensure that the 'contract manufacturing segment' meets arm's length returns. However, a lower mark-up (35th percentile of the comparable data points) can be agreed for a temporary period.

Having said the same, any third party working to recover standard costs (along with a margin) will also have the overall decision-making authority to monitor, regulate as well as keep the utilisation of its costs within its control but the same is possible in case of I Co. and F Co., for contract manufacturing

segment. Hence, risk of utilisation of the costs cannot be saddled on I Co. and should be borne by F Co. only

Allocating idle capacity costs (illustrative)

Option 1 – Ascertain direct expenses (utilized / unutilized) incurred under each segment. Then all the other indirect expenses (utilized / unutilized) can be allocated in the ratio of direct expenses

Option 2 – Identify idle costs and allocate in the ratio of trend / historical unutilized costs incurred by I Co. in past 2-3 years from both segments

GCC: In principle, a TP method should be changed only if the accurate delineation of the actual transaction has significantly changed. While typically the TNMM could be an appropriate method, previous years' comparables may not be useful in determining 2020 prices (see question 2 above). I Co. could also consider using the CUP method, as internal comparables from the licensed manufacturing segment may reflect the arm's length remuneration of 2020 sales. It is common third party behaviour to pass on some of the extraordinary costs or changes on demand to the market (provided the bargaining power of the buyer and of the seller and other economic circumstances of the market). If in the case at hand the price of sales from I Co.'s licensed manufacturing segment to third party customers has been adjusted to reflect the current circumstances, the adjusted price could be a better comparable to arrive at an arm's length remuneration for I Co.'s sales to AEs. Nevertheless, also on the CUP method, comparability adjustments may be needed to account for any material differences if such adjustments can be performed on a reliable manner.

Allocation of idle capacity cost will depend on the functional analysis, in particular in determining which party is actually taking

risk-related decisions. For the licensed manufacturing segment, one must analyze to which extent it assumes risks related to market and distribution activities and if F Co. provides binding detailed instructions on the volume of manufacturing and on other key decisions (e.g. closure or reduced hours of the manufacturing plant – assuming this was not determined by governmental restrictions). In the contract manufacturing segment, I Co. is not responsible for any marketing or distribution activity and this is assumed to be done by F Co. as part of the various management services provided. In both cases, I Co. needs to demonstrate that F Co. bears the risks related to the non-production.

Any changes made to the allocation of idle costs and risk allocation should be properly reflected in the segmented financials, especially if found that the licensed manufacturing and the contract manufacturing segments have different risk profiles (e.g. due to the marketing and distribution functions attributed to the licensed manufacturing segment). It is also important to note that if any additional risks are attributed, proper capital should be allocated to ensure that the segment has the financial capacity to assume the risk.

5) *Considering the lower volume of sales and higher input cost, the company has been projected to incur huge losses in its licensed manufacturing segment. What defense documentation should I Co. maintain to justify the ALP of imports, royalty and management charges payable to AEs in the licensed manufacturing segment?*

HG: In the given scenario, TNMM has been adopted as the most appropriate method historically, testing I Co.'s licensed manufacturing segment margins using the aggregated approach. This is an indirect

method of concluding that the higher margins earned in licensed manufacturing segment justify the ALP of individual components of AE costs, without justifying them individually. The aggregated approach can be considered flawed since the tested party selected (here I Co.'s licensed manufacturing segment) may not be the least complex entity among the transacting parties. Tax authorities have historically challenged this aggregated approach and proposed adjustments to individual transactions like royalty and management fees by testing them individually.

In the current scenario, considering the multifold impact on supply chain and demand, I Co. may be required to make multiple economic adjustments to justify the ALP using the historic approach. Voluminous documentation would be required to be maintained to justify that the losses are not on account of mispricing of inter-company transactions. This approach though may be prone to significant litigation.

Alternatively, I Co. could consider adopting a transaction by transaction approach and to justify the transactions, it would be prudent for I Co. to test these individually. While doing so, due consideration should be given to impact of such approach on previous and future years, disclosures in master file and availability of documentation to support such analysis. This approach is direct and is not subject to the difficulties of justifying licensed manufacturer's profitability, which is dependent on market factors, most of which are beyond the control of entities within the group.

It will thus become very important for F Co. to have a robust transfer pricing policy tailored to adhere to regulations in each jurisdiction and have periodic reviews to ensure the policy reflects the changes in economic circumstances of the parties and the industry.

Also, the need of the hour is to marry the price setting methodology with price testing.

VI: OECD TP Guidelines 2017 as well as several Indian court rulings have upheld a principle that any intra-group payment should meet four principle test (i) Commercial & economic benefit (ii) Actual rendition of service during the year (iii) Not shareholder activity in nature; (iv) Non-duplicative services

While robust documentation demonstrating how the above four principles are satisfied should definitely be maintained for any intra-group pay-out. Additionally, in a case where ICo. has renegotiated prices with its vendors citing pandemic impact, similar re-negotiation for intra-group pay-outs with FCo. should be undertaken and underlying documentation should be maintained (especially for imports) demonstrating (i) re-negotiation discussions regarding pricing, relaxed payment terms, reduction in scope of work etc. (ii) Comparison of renegotiations / discounts sought from other vendors vs intra-group pay-outs.

In case of losses suffered by ICo. for the licensed manufacturing segment, it should be minutely analysed to ascertain which of the participating entities (ICo. and FCo.) are performing the key risk controlling functions and controlling the economically significant risks. If such analysis confirms that only ICo. is performing the key risk controlling functions and assuming all the economically significant risks then it may not be appropriate to choose ICo. as the tested for this segments and hence, FCo. can be selected as the tested party for the TNMM analysis. However, if the analysis confirms that ICo. and FCo. jointly performing the key risk controlling functions and assuming all the economically significant risks, Profit Split Method should be selected to split the profits / losses arising from such business.

GCC: Intercompany agreements can be the starting point for substantiating I Co.'s defense strategy regarding its licensed manufacturing segment. However, it should be demonstrated that the economic reality of the various transactions follows the intercompany agreement.

As such, in defending the royalty charges, I Co. should demonstrate that it uses the technology/know-how provided by F Co. in its manufacturing process. For the management charges payable to F Co., I Co. should keep documentation substantiating the benefits received from such services, that third parties would be willing to pay for the services or perform them in-house, that there is no duplication of the services and that they do not constitute shareholder costs.¹³ Finally, on justifying the ALP of imports, I Co. can provide the supply agreements with third parties as an internal comparable for the import of raw materials from AEs, provided that the raw materials provided are the same and that there are no material differences between the two transactions or comparability adjustments can be performed in a reliable manner.

6) What factors/documentation should be considered/maintained to substantiate the higher management cross-charge arising out of increased involvement of AEs during these times?

HG: It is practically possible that the time spent by the executive and functional leadership teams could increase during the pandemic to address the uncertainty and manage supply-demand disruptions. This higher cross-charge is likely to be challenged by the tax authorities considering the lack of profits in the Indian entity. Tax authorities may allege that the overall charge need not increase if the same set of people who assisted prior to the pandemic, assisted during the pandemic year as well. In fact, the tax authorities may

call for records to check if there were any salary or other cost reductions in F Co. and therefore the management charge costs allocated ought to have been lower.

As discussed in Qn. No. 5 above, the key to justifying the higher management fee shall be maintaining detailed cost benefit documentation to substantiate the time spent (through meeting notes, reports, review notes etc.), services received and benefits derived therefrom, and the manner of arriving at the cross-charge and mark-up, if any.

Some of the additional time spent by the service provider may be in the capacity of a shareholder, to supervise / oversee the operations with a view to protect the investment in the Indian subsidiary. Such shareholder activity does not merit a charge since the subsidiary does not accrue any benefit from such activities. Thus, in arriving at the inter-company cross charge, such costs should be clearly identified and reduced.

Similar to the exercise discussed in Q. no. 1 and 2 above, F Co. should proactively review the mark-ups applied based on trends in margins of comparables and consider applying a lower / no mark-up or adjust the cost base, depending on facts and circumstances of the case. A contrary position taken for consideration of services provided vis-à-vis charge for services received may invite questions.

In the absence of pro-active and contemporaneous documentation substantiating the need-benefit analysis of the services received, taxpayers are likely to face protracted litigation with respect to these intra-group payments.

VI: Several documentation, for instance email correspondences, board minutes, calendar entries, agendas & minutes of audio/video con-calls, demonstrating strategic involvement of

the AEs to help the local business deal with the pandemic impact globally as well as for Indian operations. However, caution has to be exercised to ensure that AEs do not cross-charge for any activity which may qualify as a shareholder function.

GCC: Transfer pricing contemporary documentation is of utmost importance at current uncertain times. The higher management cross-charge can be justified by the higher volume of the management services. However, to substantiate these charges the group needs to well document what decisions were made in relation to risk mitigation and business continuity and where such decisions were taken (e.g. at F Co.'s level). It is crucial to demonstrate to which extent I Co. is involved in each decision, if at all.

A proper functional analysis also tests intercompany agreements, in particular in relation to the risk allocation. While it is important to ensure that the conduct of the parties follow the risks and functions delineated in the intercompany agreement, it is possible that risks that were not foreseen in the agreement are materialized. In this case, the group must keep substantial documentation on how the parties are actually behaving, what is their decision-making roles and which risks they are bearing.

Moreover, considering that each segment may need different support from F Co. and the change in economic circumstances, it may be more appropriate to allocate the management services fees on the basis of hours spent by F Co.'s employee's working for the benefit of each segment instead of the current general allocation based on external sales. This would be especially relevant in justifying deduction of management fees, as it may only be allowed if the cost could be traced to a specific management service. In order for the services to be chargeable, it

should be demonstrated that: (i) I Co. actually benefits from the services; (ii) that a third party would be willing to perform the same service in-house or pay for it; (iii) that there is no duplication of services; and (iv) that the services do not represent shareholder costs.¹⁴

Apart from intercompany agreements, the group can keep documentation detailing the entities' daily operations, such as e-mail communication, meeting notes, and timesheet of F Co.'s employees demonstrating their involvement in the management services provided to each AE. Moreover, board meeting notes can be useful in substantiating how key decisions were made.

7) Should the Group consider waiver of royalty for one year? What are the various factors to be considered and the risks that entail from such proposal?

HG: Royalty is most commonly structured as a percentage of sales made by the licensee. In a downturn, the absolute amount of the royalty payable to licensor reduces proportionate to the reduction in sales. Where F Co. continues to license the technology / tradename and perform DEMPE functions relating to the IP, there may be no legal obligation to waive the royalty. I Co. should maintain documentation to substantiate the ALP of royalty paid on a stand-alone basis.

However, considering the extent of impact and to support the licensees, licensors may consider waiving the royalty or reducing the royalty rate for a specific period. While doing so, the reasons, rationale and period of such discount should be clearly documented.

It is likely that the tax authorities may allege that the discounted royalty rate be applied to previous and / or future years. Thus, it is important to document that the discount is a non-obligatory financial support or subvention provided by the licensor, which is not applicable to any other period. In addition,

implications of free-of-cost / discounted use of IP under Goods and Services Tax (GST) laws merit consideration. Another important aspect to consider is the acceptance of such waiver / discount in F Co.'s jurisdiction.

As the economy recovers from the pandemic and I Co.'s losses reduce, F Co. could consider a step-up approach for increasing the royalty rates and restoring the same to the pre-agreed level over a period of time, supplemented through a profit split analysis. Such analysis could be supplemented either based on contribution profit split or using a residual profit split analysis, based on the extent of contribution made by the parties to the technology and trade intangibles. Industries which have had a permanent impact on the business model and its profitability will require a relook of the charge for the transfer / licensing of intangibles within the Group. The royalty rates agreed should reflect the economic realities of the business and profitability of the licensee in the post COVID era.

The importance of contemporaneous documentation to support such changes cannot be over-emphasized.

VI: Waiver / Moratorium of royalty can be evaluated (illustratively) by :

- Comparing the discounts or revised payment terms being agreed with third party vendors
- Evaluating if comparable agreements (CUTs) include any clause for discounts / relaxed credit terms in case of genuine business needs
- Moratorium, as an option, can be evaluated by ICo. & FCo. by evaluating the projections of ICo. post pandemic impact. Under such option, FCo., can agree with reduced royalty with varying payments across a term (of say 3-5 years) wherein effective royalty to be paid by ICo. over the agreed term meets arm's length principles.

Hence, reduced / Nil royalty in initial years can be adjusted with a higher royalty in future years. Any variance between actual results vs projections can be adjusted (through a credit note / debit note) towards the end of term being tested.

GCC: The group may consider waiving the royalty payment for a year if it wants to support I Co.'s manufacturing segments, allowing an increased cash flow at the manufacturing level. This could be justified from an ALP perspective if the group can prove that unrelated parties would have agreed with such arrangement under similar circumstances. In doing so, the options realistically available to both parties to the transaction should be analyzed. From an I Co.'s perspective, if it continues to pay the royalty it may incur even higher losses and compromise business continuity. From F Co.'s perspective, if the royalty is not temporarily waived, I Co. may run out of business and F Co. would lose important manufacturing entities. If they were unrelated parties, F Co. would need to find another manufacturer to pass on technology and know-how to produce its products, which could be a more burdensome option.

Apart from the waiver, the group may also consider renegotiating the pricing structure of the royalty. Variable royalties may have more flexibility to pick up the change in the economic circumstances if those are linked to profitability. Whether the royalty is fixed or variable, when pricing the royalty payments, the development, enhancement, maintenance, protection and exploitation (i.e. DEMPE) functions performed by each entity (in particular in relation to the marketing and distribution functions of the licensed manufacturing segment) should be considered.

Any changes to that respect should be well substantiated and intercompany agreements may be changed, if necessary, to reflect the new arrangement. Tax administrations may challenge this approach, in particular from F Co.'s jurisdiction as F Co. will not receive the royalty payment or will receive a reduced payment. In this regard, the options realistically available are analysis and, if available, information from unrelated parties, may be useful in defending the group's position. Finally, tax administrations may challenge the royalty waiver or renegotiation also from a withholding tax perspective. Further, regulatory and legal issues may need to be considered.

Response to these questions are personal views of the Authors. Examples / options discussed in the responses are illustrative and the same should not be considered as an exhaustive list

¹ Para 6.1.2.3, Table 5.4 under Para 5.3.2.19, and Table A.11 under Part 3, of United Nations Practical Manual on Transfer Pricing for Developing Countries

² Para 1.46 of OECD TP Guidelines 2017

³ S. Prasanna & G. Capristano Cardoso, *Developing a Transfer Pricing Policy Framework for the Current Economic Crisis and Beyond*, 27 Intl. Transfer Pricing J. 5 (2020), pp. 3-18, Journal Articles & Papers IBFD (last accessed 11 October 2020).

⁴ See OECD TPG, paras. 1.56-1.70.

⁵ See OECD TPG, para. 7.6, and UN TPM paras. B.4.2.3. to B.4.2.6.

⁶ Whether the COVID-19 pandemic can be regarded as a force majeure will depend on the specific agreement (e.g. if it has a specific wording on pandemic or disease). Also important to note is that the impossibility to perform the contractual obligation should be linked to the pandemic directly. As such, if the non-performance is only a secondary

effect to the COVID-19-related economic crisis, the force majeure clause for unilateral termination or substantial unilateral renegotiation may not be valid. See Prasanna & Capristano Cardoso, *supra* n. 1.

⁷ See OECD, *Secretariat Analysis of Tax Treaties and the Impact of the COVID-19 Crisis* (3 April 2020), available at https://read.oecd-ilibrary.org/view/?ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis

ref=127_127237-vsdagpp2t3&title=OECD-Secretariat-analysis-of-tax-treaties-and-the-impact-of-the-COVID-19-Crisis (last accessed 11 October 2020). Further, some tax administrations have issued guidance exempting from creating a PE in case of stranded remote workforce, e.g. FAQ section on the Australian Tax Office's website, available at <https://www.ato.gov.au/General/COVID-19/COVID-19-frequently-asked-questions/>

[International-business-frequently-asked-questions/#PermanentestablishmentPE and IE: Revenue, Revenue eBrief No. 046/20, Advice and information to assist taxpayers and their agents during the COVID-19 pandemic](https://www.revenue.ie/en/tax-professionals/ebrief/2020/no-0462020.aspx) (23 March 2020), available at <https://www.revenue.ie/en/tax-professionals/ebrief/2020/no-0462020.aspx> (both last accessed 11 October 2020).

⁸ See OECD TPG, paras. 3.4. and 3.5.

⁹ *Ibid*, chapter VII, s. D. and UN TPM, paras. B.4.5.3–B.4.5.10.

¹⁰ Platform for Collaboration on Tax, *A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses* (2017), available at <https://www.tax-platform.org/sites/pct/files/publications/116573-REVISED-PUBLIC-toolkit-on-comparability-and-mineral-pricing.pdf> (last accessed 11 October 2020).

¹¹ R. Petruzzi, *Dealing at Arm's Length in Times Of Social Distance: A Case Study*, 99 *Tax Notes International*, 12, (21 September 2020), pp. 1599-1603.

¹² *Ibid*.

¹³ C. Peng & R. Petruzzi, 'Transfer Pricing and Intra-group Services', in: Lang, Cottani, Petruzzi, Storck (eds), *Fundamentals of Transfer Pricing: A Practical Guide* (Vienna: Wolters Kluwer, 2018).¹² *Ibid*.

¹⁴ *Ibid*.

KEY INTERNATIONAL TAX UPDATES

Compiled by:

Seema Kejriwal, Aman Thakkar and Ameya Khare

1. Chile Adopts Master File and Local File Requirements

The Internal Revenue Service (SII) published a Resolution No. 101 (dated 31 August 2020) which has established an obligation on taxpayers to file master file (Form 1950) and local file (Form 1951). Chile is an OECD member country and it had already implemented filing of Country by Country (CbC) Report vide Resolution Ex. SII No. 126 of 2016. With this new requirement, Chile is aligned with the three-tiered documentation approach of OECD's base erosion and profit shifting (BEPS) project. The due date to file both the forms (ie Form 1950 and 1951) is the last business day of June of the year following the reporting year, and the deadline may be extended only once,

for up to three months. The language of both master file and local file may be in Spanish or English. Both these forms have to be filed electronically in the prescribed format.

http://www.sii.cl/normativa_legislacion/resoluciones/2020/res_ind2020.htm

http://www.sii.cl/normativa_legislacion/resoluciones/2020/reso101.pdf

2. Oman introduces CbC reporting requirements

Oman introduced, CbC reporting requirements through Tax Authority Decision No. 79/2020 (TA Decision 79/2020) issued on 17 September 2020. The CbC report rules are effective for fiscal years beginning on or after 1 January 2020. These rules apply to all businesses that

¹⁵ Please note that key international tax updates pertaining for the period July 2020 to September 2020 have been considered in this issue.

have a legal entity or branch in Oman and are members of a MNE group with annual turnover above OMR 300 million.

https://tms.taxoman.gov.om/portal/web/taxportal/tax-laws/-/document_library/LJstlnedqI9s/view_file/828254

3. OECD releases outcomes of the third phase of peer reviews on Action Plan 13 of the BEPS project

As Action Plan 13 is one of the four BEPS minimum standards, it is subject to peer review to ensure timely and accurate implementation. The peer review process focuses on three key elements of the minimum standard: (i) the domestic legal and administrative framework, (ii) the exchange of information framework and (iii) the confidentiality and appropriate use of CbC reports. Implementation of CbC Reporting is well underway as the peer review suggests over 90 jurisdictions have now introduced an obligation for relevant MNE Groups to file a CbC report in their domestic legal framework. <http://www.oecd.org/tax/beps/country-by-country-reporting-Compilation-of-peer-review-reports-phase-3-fa6d31d7-en.htm>

4. Turkish Government provides detailed information regarding the new transfer pricing documentation requirements

On 1 September 2020, Turkish Government has published a communique which provides for detailed information related to new transfer pricing documentation requirement. It also provides for additional explanation and examples related to 10% share of partnership requirement for status of related party as well as a lower threshold of TRY 30,000 for the related party transaction that would be included in the documentation.

The General Communiqué on Disguised Profit Distribution through Transfer Pricing (Series No:4) (the Communiqué) in the Official Gazette.

5. Australian Taxation Office (ATO) releases draft guidance on outbound interest-free financing between cross-border related parties

The draft Schedule outlines the ATO's views on factors that may be considered to risk score an outbound interest-free loan arrangement. The draft Schedule's starting point for an outbound interest-free loan arrangement is a presumption that the arrangement is high risk (amber risk zone) before consideration of any other characteristics of financing arrangement. The ATO states in the draft Schedule that such arrangements present a "high" transfer pricing risk on the basis that in an independent scenario, loans are not provided by independent parties on an interest-free basis.

<https://www.ato.gov.au/law/view/document?DocID=DPA/PCG20174DC2/NAT/ATO/00001>

6. Australia releases final taxation ruling and practical compliance guideline ('PCG') relating to arm's-length debt test ('ALDT') for Australian thin capitalization

The final taxation ruling addresses the application of the ALDT from a legislative perspective and the PCG provides administrative guidance to taxpayers when applying the ALDT. Historically Taxation Ruling TR 2003/1 endeavored to cover both the legislative interpretation and guidance piece of the ALDT. However, the ATO has split these into separate publications that are to be read together. While the ruling is largely consistent with TR 2003/1, PCG focuses on increased analysis and documentation expectation of ATO from taxpayer while applying ALDT.

<https://www.ato.gov.au/law/view/view.htm?docid=%22TXR%2FTR20204%2FNAT%2FATO%2F00001%22>

<https://www.ato.gov.au/law/view/view.htm?docid=%22COG%2FPCG20207%2FNAT%2FATO%2F00001%22>

7. OECD releases new corporate tax statistics including anonymized and aggregated country-by-country report statistics

OECD released the second edition of the annual Corporate Tax Statistics publication with an intention to assist in study of corporate tax policy and expand the quality and range of data available for analysis of BEPS.

The database also includes anonymized and aggregated CbC reporting statistics, reflecting information for the year 2016 provided by 26 member jurisdictions of the Inclusive Framework on BEPS and covering about 4,000 MNE groups that operate across more than 100 jurisdictions worldwide.

This second edition of the database also includes for the first time information on controlled foreign company (CFC) rules and on interest limitation rules, which the OECD indicates can assist in understanding progress related to the implementation of BEPS Actions 3 and 4.

<http://www.oecd.org/tax/tax-policy/corporate-tax-statistics-second-edition.pdf>

<http://www.oecd.org/tax/tax-policy/corporate-tax-statistics-database.htm>

8. European Commission (EC)'s decision to appeal the General Court's judgement on the Apple state aid case in Ireland

Background: In the year 2013, EC's competition directorate decided to investigate the arrangement that helped Apple pay significantly lower taxes than other companies over many years. In August 2016, EC ruled that illegal tax advantage was provided to Apple through selective tax breaks and that Apple owed the country over 13 billion euros (plus interest) that were not paid on profits earned by the company.

Update: In July 2020, the General Court annulled the August 2016 decision of the EC and the General Court ruled that the Irish

Government did not provide illegal state aid to Apple and that the EC failed to prove that Irish Government had given a tax advantage to Apple. The General Court's judgement raises important legal issues that are relevant to the EC in its application of State aid rules to tax planning cases. The EC published a statement on 25 September 2020 to state that it has decided to appeal the General Court's judgement in the case. The EC has now decided to appeal before the European Court of Justice.

https://ec.europa.eu/commission/presscorner/detail/en/statement_20_1746

9. UN Committee releases draft paper on introduction of a new Article 12B along with commentary in the UN Model Convention.

Background: While the OECD is working to achieve a consensus on taxation of digital economy under Action Plan 1 of the Inclusive BEPS Framework, the United Nations Committee of Experts on International Cooperation in Tax Matters (UN Committee) has decided to work independently on these challenges taking note of work done in other forums.

Update: The UN Committee has proposed to cover taxation of automated digital services (ADS) through introduction of an Article by amending the model tax treaty. The new Article defines nexus and determination of qualifying profits for ADS thereby providing taxing rights to the source jurisdiction. The draft paper also provides option to choose either gross basis or net basis of taxation and the tax percentage is to be established through bilateral negotiations. The draft paper is under further discussion.

https://www.un.org/development/desa/financing/sites/www.un.org.development.desa.financing/files/2020-08/TAX_TREATY_PROVISION_ON_PAYMENTS_FOR_DIGITAL_SERVICES.pdf

IFA EVENTS AND ANNOUNCEMENTS

Compiled by:

Ameya Khare

IFA Virtual Programme

IFA held its Annual Congress as virtual programme with seven webinars from 16 - 25 November 2020. It also held IFA's Young IFA Network (YIN) and Women IFA Network (WIN) virtually including the virtual poster programme. Through seven dynamic sessions, the experienced speakers focussed on important developments in the world of international taxation.

The sessions included Reconstructing the treaty network, Exchange of information: issues, use and collaboration, WIN Seminar - Impacts of the actual implementation of measures to tax digital economy, YIN Seminar - #tomorrowstaxleaders's view on #covid19, #stfah, #thenewnormal and Recent developments in international taxation

The event was opened by the IFA President, Murray Clayson and the President of the Cancun Congress, Edgar Anaya, on 16 November 2020, followed by a brief introduction on the scientific programme by the Chair of the PSC, Robert Danon.

The registration was reserved for IFA members and was without charge. The sessions have been recorded and made available to participants and are available at My IFA.

Appointment of WIN Representatives from India

IFA India branch has appointed Parul Jain, Partner at Nishith Desai Associates as WIN representative for India and Karishma Phataraphekar as deputy leader.

Appointment of Kuntal Dave as Chairman of the IFA APAC Committee

Kuntal Dave from IFA India branch has been appointed as the Chairman of the IFA APAC Committee.

IFA India Western Region's new Office premises at BKC, Mumbai

The new Office of IFA India Western Region Branch at BKC, Mumbai is now open. This new fully equipped Academy has marked the beginning of a new chapter of IFA's activities at Mumbai. The opening was celebrated by live streaming the IFA Congress sessions on 17 November, 18 November and 24 November with suitable social distancing and other precautionary arrangements at the venue. This will serve as a second center for tax research for IFA India.



IFA India Branch EARLIER HELD EVENTS:

DATE : 17-Oct-2020
PLACE : Webinar
EVENT : Transfer Pricing Year-End Compliance - Intricacies and Safeguards
DESCRIPTION : Panel discussion with leading Tax professionals and Industry experts
RECORDED LINK : www.youtube.com/watch?v=tcEKDQwKt0o
WEBSITE : www.ifaindia.in
E-MAIL: admin@ifasrc.org

DATE : 19-Sep-2020
PLACE : Webinar
EVENT : Panel Discussion on Faceless Assessments
DESCRIPTION : Panel discussion with leading experts from Ministry of Finance, Tax Departments moderated by Tax Professionals
RECORDED LINK : www.youtube.com/watch?v=m-QVlmNaO YU
WEBSITE : www.ifaindia.in
E-MAIL : info@ifaindiaacademy.in, shelly.wadhwa@ifaindiaacademy.in

IFA India Branch

FORTHCOMING EVENTS:

DATE / DAY : December 8, 2020, Tuesday *

TIME (IST) : 7.00 PM to 8 PM

TOPIC : Alternative approach to tax the digital economy

SPEAKERS : Mr. Rajat Bansal, IRS member of the UN's subcommittee on Tax Challenges of the Digitalization of the Economy.

MODERATOR : Mukesh Butani, Chairman, IFA India

LINK : <https://ifaindia.webex.com/ifaindia/onstage/g.php?MTID=ea046eb87f018d5905b5f1f5eee2f846>

* In collaboration with US-India Strategic Partnership Forum.

DATE : December 9, 2020, Wednesday

TIME (IST) : 6.30 PM to 8.00 PM

TOPIC : Case studies of Pillar One of the OECD Report on taxation of digital economy

SPEAKERS : Dr. Vikram Chand, Associate Professor & Program Director at the University of Lausanne

MODERATOR : Nilesh Kapadia, Chairman IFA India Western Regi

LINK : <https://ifaindia.webex.com/ifaindia/onstage/g.php?MTID=ee0a1159e770adab9ce563255dc7f1867>

DATE / DAY : December 10, 2020, Thursday

TIME (IST) : 6.30 PM to 8.00 PM

TOPIC : Case studies of Pillar One of the OECD Report on taxation of digital economy

SPEAKERS : Dr. Vikram Chand, Associate Professor & Program Director at the University of Lausanne

MODERATOR : Nilesh Kapadia, Chairman IFA India Western Region

LINK : <https://ifaindia.webex.com/ifaindia/onstage/g.php?MTID=eaab30acebc31c576c38afc7aece1585e>

IFA Worldwide

EARLIER HELD EVENTS:

DATE : 16-Nov-2020 - 25-Nov-2020

PLACE : IFA Virtual Programme

DESCRIPTION : Through seven dynamic sessions, the experienced speakers will focus on important developments in the world of international taxation and transfer pricing

E-MAIL : ab.gensecr@ifa.nl

DATE : 29-Oct-2020 - 25-Jan-2021

PLACE : Webinar from Singapore

EVENT : IFA Singapore

Branch : The International Tax Dialogues (ITD)

DESCRIPTION : The topics are global, contemporary and practical with series of discussions and interactive technical sessions on key emerging issues in International taxation led by international tax experts who will explain and take you through the various nuances and technical issues, followed by in-depth discussions.

WEBSITE : www.ifa.nl/media/6246/ifa-sg-q4-jan-2020-e-flyer-final-8-oct.pdf

E-MAIL : joy.ng@bakermckenzie.com

DATE : 26-Oct-2020 - 30-Oct-2020

PLACE : Webinar from Columbia

CONFERENCE : IFA Columbia Annual Summit

DESCRIPTION : Interactive Seminars and Panel Discussions with National and International Experts

WEBSITE : www.ifacolombia.com

E-MAIL : secretaria.tesoreria@ifacolombia.com

DATE : 22-Oct-2020

PLACE : Webinar from Schaan, Liechtenstein

EVENT : IFA Liechtenstein: BEPS 2.0 - fundamental change in international corporate taxation DESCRIPTION: The symposium followed by a aperitif with Interactive Seminars and Panel Discussions with National and International Experts

WEBSITE : www.ifa-fl.li

E-MAIL : info@ifa-fl.li

DATE : 19-Oct-2020

PLACE : Webinar from Sydney, Australia

EVENT : Women in IFA Network IFA Australia: Financing in a COVID world (and beyond) DESCRIPTION: Panel discussion on tax issues associated with financing in the current climate and the issues for entities on a go-forward basis

WEBSITE : www.ifa-australia.com.au/events/financing-in-a-covid-world-and-beyond
www.ifa.nl/media/6235/win-event-event-details-ifa-australia.pdf

E-MAIL : allison.scott@au.kwm.com

DATE : 02-Oct-2020 - 23-Oct-2020

PLACE : Webinar

EVENT : IFA LATAM - IBFD Webinars, News on International Taxation and its Impact in Latin America October 2020

DESCRIPTION : Seminar discussing trending topics in international taxation, particularly those with an impact on Latin America

WEBSITE : www.ibfd-conferences.org/ibfd-ifalatam-2020

E-MAIL : a.gensecr@ifa.nl



IFA~INDIA BRANCH NEWS LETTER

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IFA~INDIA

International Fiscal Association - India (IFA-India) is a society registered in Delhi (India) under the Societies Registration Act, 1860. It operates in India through its Head Office in the National Capital Region (NCR) and four regional chapters in North, South, East and West. IFA-India is governed by an Executive Committee which presently has 26 members with 6 elected office bearers among them. IFA-India is engaged in promoting better understanding on the subject of international tax and the related fiscal laws. It organises conferences, seminars, workshops, training courses and encourages discussions and conversations through various other modes like webinars and social media. The membership includes tax administrators, tax policy experts, tax court judges, and tax professionals from corporates and from consultancy. It has set up an International Tax Academy at Noida where regular learning and knowledge sharing programs are held on the theme subject.

IFA

IFA-India is a part of International Fiscal Association headquartered in the Netherlands (IFA). Established in the year 1938 as a non-profit organisation, IFA provides a neutral and independent platform where representatives of all professions and interests can meet and discuss international tax issues at the highest level. IFA has played an essential role in both, the development of certain principles of international taxation and in providing possible solutions to problems arising in their practical implementation. Its objects are study and advancement of international and comparative law with regard to public finance, specifically, international and comparative fiscal law and the financial and economic aspects of taxation. IFA seeks to achieve these objects through its Annual Congresses and the scientific publications relating thereto as well as through scientific research. Although the operations of IFA are essentially scientific in character, the subjects selected take account of current fiscal developments and changes in local legislation.

The membership of IFA now stands at more than 12,000 from 106 countries. In 62 countries, including India, IFA members have established IFA branches and IFA-India is one of those 62 branches world over. IFA-India has also taken initiatives to encourage young IFA members and Women IFA members to participate in its initiatives through YIN (Young IFA Network) and WIN (Women IFA Network).

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