CHAPTER 5:
COUNTRIES

Arm’s length principle took center stage internationally for the first time in 1936, as enshrined in Article 6 of the League of Nations’ draft Convention qua Allocation of profit and Property of International Enterprises. This chapter will highlight the different transfer pricing regimes functioning in the 4 countries and their differences/similarity qua Indian Transfer Pricing Regulations and the OECD Guidelines/framework, in re the transfer pricing adjustments made. It is these subtle or glaring variances/disparities, as the case may be, which have led to companies misusing them for carrying out Base Erosion & Profit Shifting. (BEPS)

The not-so long history of transfer pricing regime can be traced back to the early treaties resolved by the United States, United Kingdom and also France, way back in the 1920s and 1930s, though at that time such jargon was not used. Some of these earlier provisions share resemblance with the Article 9 of the 1963 OECD Draft Convention as also Article 9, paragraph 1 of the present OECD Guidelines and the current & extant UN model Tax Treaties.

Article 9 of the OECD Guidelines,\(^1\) being one of the corner stones, sets the tone for a transfer pricing adjustment by confirming\(^2\) the (domestic) right of a contracting state to adjust the profits of an enterprise located on its territory, wherein such an enterprise is managed, held or controlled directly or indirectly by another enterprise\(^3\) of the other contracting state, if the conditions in their relationship differ from the conditions\(^4\) which would have been stipulated between independent enterprises.

Let us individually lay out the TP regimes of the 4 countries – US, UK, South Korea & Mauritius.

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\(^1\) OECD Guidelines 2010, supra, n. 67.
\(^2\) In a treaty situation.
\(^3\) Referred to as the ‘Associated Enterprise’ under section 92A of the Income Tax Act, 1961, India.
\(^4\) Controlled ‘international’ transactions as contradistinguished with comparable uncontrolled transactions (CUTs).
5.1 UNITED STATES

USA was one of the first countries to initiate an extensive and encompassing writing of detailed and thorough transfer pricing regulations. It is considered to be one of the oldest and most mature transfer pricing regimes, being in fact the first country to adopt a TP legislation in 1986. The 1986 Regulations provided guidance on the application of the arm’s length standard for specific intercompany transactions. As of date it has one of the most intricate and well drafted set of transfer pricing provisions. The US corporate tax system like most developed tax jurisdictions is a self-assessment system where the burden of proof is generally placed on the taxpayer – This additional compliance burden placed on multinational enterprises by the US is not unique to the field of transfer pricing.5

5.1.1 TP Regulations and Rulings

Section 482 of the Internal Revenue Code (IRC), 1986, is the main provision dealing with the US transfer pricing regulations. The predecessors of current IRC section 482 date back to 1921 and 1928. Unlike the extant TP provisions, the earlier sections focused on the “true taxable income” of related parties, to prevent tax avoidance. Until 1934, the arm's-length principle was not used as a measure to judge the real value of the transaction. It was from 1934 that the arm’s-length standard was used for determination of cross-border inter-company transactions to see whether they indicate a clear reflection of income for US Federal income tax purposes.

Reg. 1.482-1(b)(1) provides the Arms’ length principle –

“In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm’s length with an uncontrolled taxpayer. A controlled transaction meets the arm’s length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm’s length result)”

The section as it stands today on the statute book provides – “In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.”

It was in 1986 that the IRS issued regulations laying down procedural rules for applying the arm’s-length principle and entailed specific pricing methods for testing the ALP of the questionable transactions. The section 482 saw its first amendment in relation to transfer pricing in the year 1986, in pursuance of a study conducted by the IRS, wherein the U.S. Congress amended, by including the determination of income for transfer of intangible property. It added a second sentence – that required related party transfers of intangible property to yield income “Commensurate with the Income attributable to the intangibles”.

In 1988 the US Treasury Department issued a White Paper on the study of intercompany pricing which resulted thereafter in the provision undergoing several amendments in the years 1990, 1992, 1993 and ultimately in 1994.
encompassing almost all aspects of transfer pricing regime. Regulations under this section form the main basis to apply the arm's length principle. Rules governing cost-sharing transactions saw a major proposed overhaul in 2005, when the IRS issued proposed cost-sharing regulations. The new intra-group services regulations were finalized and came into effect on 31 July 2009.

One of the most important features of these regulations are that they only apply to “related party transactions”. This can be similarly placed in the Indian context by matching it with the threshold condition of applicability of the Indian transfer pricing regulations only to a case of an ‘International Transaction’ between two or more ‘Associated Enterprises’. The ‘control’ underlying such ‘related party’ transactions is applicable to two or more enterprises, that are owned or controlled directly or indirectly by the same interests.

5.1.2 Interpretation of Arm’s Length Principle (ALP) & TP methods used

The arm's-length principle is the standard followed by the US transfer pricing regulations. The ALP is derived following a similar modus operandi as detailed out previously. It is reached after applying the transfer pricing methods to the controlled and the comparable uncontrolled transaction. Similar to the Indian TP Regulations, under the US Regulations also, five methods are mainly used for arriving at the ALP which are – comparable uncontrolled price method, resale price method, cost-plus

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14 Temporary regulation issued in 1993; during this time amendments focused on whether the tax payer generate contemporaneous documentation and analysis of its TP decisions and provide such documentation in response to requirement.

15 IRS issued final regulations under section 482 in July 1994, effective for tax years beginning after 6 October 1994.

16 Recommended On 22 August 2005 - These proposed regulations focus on three new specified methods of valuation for determining the arm’s-length buy-in amount.

17 Reg. 1.482-1(i)(4) defines “controlled” as – “Controlled includes any kind of control, direct or indirect, whether legally enforceable or not, and however exercisable or exercised, including control resulting from the actions of two or more taxpayers acting in concert or with a common goal or purpose. It is the reality of the control that is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.”


19 Pl see Chapter 3 & 4.
method, profit split method and comparable profits method\(^{20}\); or any other suitable/prescribed method. A strong preference is given to traditional (as opposed to profits-based) methods that rely on comparable uncontrolled transactions and on verifiable, reliable external data. This would not be in consonance with the OECD Guidelines and the Indian TP regulations, which have removed the preference of one method over another and provide no inter-se hierarchy amongst the methods adopted.

5.1.3 The Best Method Rule

Similar to the concept of most appropriate method (MAM) as applied in India, the golden thread running through the usage and applicability of the US TP regulations and methods therein is that of the Best Method Rule. The method chosen should be based on objective criteria and after carefully considering and taking into account the comparative circumstances between the controlled and uncontrolled transactions and importantly the availability, relevancy and verifiability of the data for the said transactions and the tested party. The rule is applied not just for choosing\(^{21}\) the methods but also for other ancillary aspects like selection of comparables, making adjustments and data analysis.

5.1.3.1 The Reasonableness Test.

Unlike under the Indian TP regulations where the 5 methods are provided under different sub-Rules under the Income Tax Rules, the US TP method selection provide for a preliminary test – known as the reasonableness test – where the US TP regulations specify a total number of seven elements that may be considered during the course of ascertaining in re the reasonability in an assessee’s/tested party’s “selection and adoption of any transfer pricing method.”\(^{22}\)

1. The experience and knowledge of the taxpayer and its affiliates.

\(^{20}\) Similar to the TNMM method used in India.

\(^{21}\) When an assessee is adopting a prescribed specified method, he is not required to prove that why and how the other methods are inapplicable.

\(^{22}\) PwC, *International Transfer Pricing 2013/14*, supra, n. 213, p. 834-835
2. The availability of accurate data and the thoroughness of the taxpayer’s search for data.

3. The extent to which the taxpayer followed the requirements of the transfer pricing regulations.

4. The extent to which the taxpayer relied upon an analysis or study prepared by a qualified professional.

5. Whether the taxpayer arbitrarily sought to produce transfer pricing results at the extreme point of the arm’s-length range.

6. The extent to which the taxpayer relied on an advance pricing agreement applicable to a prior tax year, or a pricing methodology specifically approved by the IRS during an examination of the same transactions in a prior year.

7. The size of a transfer pricing adjustment in relation to the magnitude of the inter-company transactions out of which the adjustment arose.”

As suggested by the researcher in chapter 3 and 4 that a “commercial rationality test” may be used preceding the selection and application of methods. This commercial rationality test can be worded along the same lines as the reasonableness Test expounded under the US transfer pricing regulation.

Another aspect to be considered is that, in stark contrast to the Indian TP regulations, which restricts the selection pool to ONLY the 6 methods prescribed under the Act, under the US transfer pricing regulations on the other hand, taxpayers and authorities alike may choose to apply any unspecified method apart from the six prescribed methods for arriving at an arm's length price. For example, there are 3 more prescribed methods in relation to reaching the ALP in respect of providing of ‘inter-company services’ – comparable uncontrolled service

23 The IRS and Treasury issued final Section 482 regulations on 31 July 2009 which – require taxpayers to apply the arm’s-length standard in establishing compensation amounts for the provision of inter-company services. Thus, similar to other sections of the transfer pricing regulations, taxpayers involved in the provision of inter-company services must adhere to the best method, comparability, and the arm’s-length range requirements of Treasury Regulation No. 1.482-1. What is new is that the final service regulations stipulate that taxpayers must apply one of the six specified transfer pricing methods or an unspecified method in evaluating the appropriateness of their inter-company services transactions. The six specified transfer pricing methods include three transactional approaches, two profit-based approaches, and a cost-based safe harbour. The transactional approaches are the comparable uncontrolled services price method (CUSPM), the gross services margin method (GSMM) and the cost of services plus method (CSPM). The two profit-based approaches are the existing
price method (CUSPM), gross service margin method (GSMM), and cost of services plus method (CSPM).\textsuperscript{24}

A peculiar aspect in case of the US TP regulations, \textbf{as distinct from Indian Transfer Pricing Regulations} is, that \textbf{though any unspecified methods may be used}, as described above, as long as the assessee has established such a method yielding the most steadfast proximation of the arm’s-length price, BUT additionally the Assessee/taxpayer\textsuperscript{25} would have to “\textit{demonstrate with contemporaneous documentation that it has made a reasonable effort to evaluate the potential applicability of other methods before selecting its best method.}\textsuperscript{26}

The comparability factors, based on a functional analysis, to be taken into consideration herein, so as to arrive to a degree of comparability, \textbf{are similar to the Indian transfer pricing regulations} –

\begin{itemize}
  \item FAR analysis
    \begin{itemize}
      \item Functions performed
      \item Assets employed
      \item Risks assumed
    \end{itemize}
  \item contractual terms
  \item characteristics of the property
  \item services undertaken.
\end{itemize}

\textsuperscript{24} Inland Revenue Regulations, July 2009; retrospectively applicable from 10.09.2003.
\textsuperscript{25} In order to make sure that no penalties may get imposed.
\textsuperscript{26} PwC, \textit{International Transfer Pricing 2013/14}, supra, n. 213, p. 820.
5.1.4 LEGAL CASES as examples highlighting the disparity/similarity.

CPM (Cost Plus Method) & CUP (Comparable Uncontrolled Price) Method

*Bausch & Lomb, Inc. v. Commissioner of Internal Revenue*\(^{27}\)

The US tax court in this case affirmed the application of the CUP method\(^{28}\) instead of the CPM method\(^{29}\) by negating the revenue’s ‘contract manufacturer theory’ which was used by the tax department to further its justification of use of the CPM method. The court observed that the mere provision of supplying the technology and the related intangibles, would by itself not make CPM applicable to the contract manufacturer.

Disparity – US courts thus exhibit clear deviation from Indian transfer pricing provisions, the UN Practical Transfer Pricing Manual Guidelines as well as the *OECD Guidelines* in the application of the CPM method to these such facts and circumstances and holding the assessee as a contract manufacturers\(^{30}\).

PSM (Profit Split Method) and the CPM (cost-plus method)

*Altman Delta Corporation v. Commissioner of Internal Revenue*\(^{31}\)

This case involved a cost-sharing arrangement between the assessee (US company) and its wholly-owned subsidiary wherein the IRS used cost plus method by comparing the profit margin of three other manufacturers of military boots and by adding a relevant gross markup. The US tax Court held that the IRS erred in using the cost-plus method and adopted the profit split method. This finding came in light of the fact that the comparable firms could not be compared to the military board

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\(^{27}\) 92 TC 55.

\(^{28}\) As applied by the Assessee.

\(^{29}\) As applied by the IRS.

\(^{30}\) See, for application of the CPM method in such cases under the Indian TP Regulations – Case of *GEBE P Ltd* (CPM Method); *supra*, at p. 62 & 66.

Also see reliance, (for preference of CPM method in contract manufacturers cases), on the UN Practical Transfer Pricing Manual for developing countries, 2012, in Para 6.2.20.2 and 6.1.3.3; The OECD Guidelines 2010, *supra*, n. 67, under Para 2.2 and 2.53.

Also see Whatson Pharma ruling, *infra*, for use of TNMM method exceptionally, in such cases.

\(^{31}\) 104 TC 22 (1995).
manufacturer assessee who had to actually design the products instead of merely manufacturing to a specified specification. This constant price once arrived at by using the PSM was thereafter used to determine the subsidiary’s share of the cost sharing agreement.\textsuperscript{32}

Disparity – The reasoning advanced by the US Tax Court for choosing PSM (Profit Split Method) instead of the CPM (cost-plus method) method, was due to the difference in comparables due to the product dis-similarity between the two comparable firms; BUT under the Indian TP regulations a product dis-similarity distinction would only be taken into consideration while choosing inter-se between the traditional methods (CUP, RPM or CPM) and not be the only distinguishing factor between the CPM (traditional method) and PSM transactional profit method.

Similarity – That having been said, the applicability of the PSM method under the US transfer pricing regulations, is quite similar to the PSM method applied under the Indian TP regulations. It compares the arm’s length price in relation to a profit margin derived from comparable uncontrolled transactions by unrelated entities engaged in similar businesses.

Alternatively as per the researcher, even the TNMM method can be applied to such a case where the PLI\textsuperscript{33} used under this CPM method could be similar to the ones used under the TNMM Method, i.e., operating profits over a suitable base like Costs, for this international transaction of cost-sharing arrangement between the assessee and the associated enterprise.

RPM (Resale Price Method)

\textit{Paccar Inc \& Subs v. Commissioner of Internal Revenue}\textsuperscript{34}

The assessee company was into the business of selling trucks and it's parts to its wholly-owned US subsidiary which in turn carried out all related foreign marketing, and was granted 10\% discount in lieu of the same. The IRS invoked section 482 and disallowed the deduction for discount.

\textsuperscript{32} See also in this regard, \textit{PPG Industries, Inc. v. Commissioner}, 55 TC 928 (1970).

\textsuperscript{33} Profit level indicator.

\textsuperscript{34} (85 TC 754).
The US tax court applied the **RPM (Resale Price Method)** by determining the prices charged by the Assessee’s manufacturing divisions from the domestic dealers comparatively.

**Disparity** - On one hand though the *OECD Guidelines*\(^{35}\) recognizes the RPM method as the go to method in transactions involving discounts for the international transaction of selling of goods; but on the other hand, the *Indian TP authorities*, while assessing the expenses, for such an international transaction of selling of goods, incurred in relation to commissions, discounts, volume rebates and other similar trade discounts, have often disallowed the same by using either the CUP or the TNMM method by not regarding the expenses as having been incurred for improving the brand visibility\(^{36}\).

### 5.1.5 Documentation Requirements

At the very outset, it may be pointed out that this sub-head directs the attention of the reader towards the indispensable documentation requirements under the US TP Regulations, which are similarly placed to the OECD Guidelines as amended by the new 2013 CbC\(^{37}\) (Country by Country Reporting Rules).

The documentation requirements are one of the most important issues within the transfer pricing regime as they are the initial stages which may eventually determine whether at the end of the day, a transfer pricing adjustment needs to be made or not. To enable more efficient access to information, new information, reported and record keeping requirements have been made mandatory by the US government by amending Sections 482, along with other sections\(^{38}\) during the years 1988 and 1992.

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\(^{36}\) Not taking them as valid expenses under the AMP (Advertisement, Marketing & Promotion Expenses). See Sony Delhi High Court (TNMM Method, AMP Expenses) and Serdia chemicals (CUP Method) & Ranbaxy (TNMM Method)

\(^{37}\) Where the countries need to provide individual TP Reports to all countries where the individual businesses are located.

\(^{38}\) Sections amended were 6038A, 6038C, and 6503(k).
US was one of the first countries to incorporate the contemporaneous documentation requirement, which imposes the onus upon the Assessee to maintain sufficient documentation with regard to the selection and application of a pricing method. The Assessee must provide the said documentation to the Inland Revenue service that is the tax department, within a period of 30 days from the date of request by the Department for providing any such documentation\(^{39}\) including and especially in regard to the modus operandi used to arrive at the arm's-length price.

The final US Documentation Regulations which now incorporate the contemporaneous documentation, pertinently have not retained the earlier 1993 regulations’ documentation requirements in relation to methods used qua intangibles, etc., which puts the US regime on a less onerous footing compared to some other jurisdictions (e.g. Canada, Australia, and India).\(^{40}\)

Under the US transfer pricing regulations in relation to the requirement for documentation - two sets of documents are to be provided to meet this documentation requirement – **Principal documents and Background documents.** The former encompasses documentation filed along with the tax return, incorporating within its fold the assessees’s business, FAR Analysis, related party transactions, controlled party transactions, the TP method chosen with due reasoning provided, alongwith the requirement of explaining the inapplicability of any alternative method not adopted\(^{41}\); the latter relates to supporting documentation\(^{42}\) listed under Section 6038A of the regulations, which is to be provided within 30 days only on a separate special request by the IRS.

\(^{39}\) In relation to the respective Assessment Year/s.

\(^{40}\) PwC, *International Transfer Pricing 2013/14, supra*, n. 213, p. 835; That having been said, in regard to the contemporaneous documentation, the IRS has indicated stepping up enforcement of the 30-day rule and adopting a standard practice of requiring field examiners to request a taxpayer’s contemporaneous documentation within 30 days at the commencement of every examination of a taxpayer with significant inter-company transactions (see announcement by the commissioner of the IRS Large Business and International (formerly Large and Midsize Business) Division (on 23 January 2003)); *ibid*, at p. 835.

\(^{41}\) This is in clear contrast with the Indian TP documentation requirements, where only the reasoning for the correct method chosen is to be provided, unless later required under any of the queries put forth by the Assessing Officer or at litigation/appellate stages.

\(^{42}\) In support of the principal documentation.
5.1.6 Advanced Pricing Agreements (APAs)

One of the most important aspects of this study is to reduce the double taxation around the globe due to the inconsistencies arising out of different transfer pricing rules in different countries. This is where the importance of the Advance pricing agreements come in, through which these inconsistencies are reconciled by having common taxing provisions in these agreements binding on both the Assessee and the tax departments of both the countries.

The US using its influence has facilitated in building an international consensus in favour of the Arm’s Length Standard. All of its treaties (except with Soviet Union) contains Articles requiring mutual application of Arm’s length principle to resolve TP disputes. It was the first path breaker country, laying down a comprehensive set of guidelines on binding APAs, in consonance with the arm's-length standard. Under the US procedure, any assessee before getting into the rigors of an APA can request for a pre-filing conference (PFC) to explore informally the suitability of an APA and get aware as to the extent and level of information requisite as per the Rules by the IRS.

USA has an established and comprehensive APA procedure, which was first set up in the year 1991. Similar to the options provided under other countries’ TP APA Rules, here also, the Assessee may choose to enter into a unilateral, bilateral or multilateral APAs. The procedure to be followed during the negotiations of an APA are now codified under the Revenue Procedure 2006–9.

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44 As of 31 December 2009, the IRS APA Program had completed 904 APAs since inception and had 352 pending. The IRS completed 63 APAs during the year ended 31 December 2009, consisting of 21 unilateral (with IRS only) and 42 bilateral/multilateral (with both IRS and tax authority of US treaty partner) agreements. <http://www.ey.com/gl/en/services/tax/international-tax/guide-to-advance-pricing-agreements--apa----united-states-of-america>

45 Rev. Proc. 2006-9, Published on January 9, 2006; <https://www.irs.gov/pub/irs-drop/rp-06-9.pdf> last visited on 05.07.2016; 2006-2 I.R.B. ___ Internal Revenue Service (I.R.S.) Revenue Procedure, Released: December 19, 2005; “The 2006 Revenue Procedure includes a strongly worded warning that a unilateral APA may hinder the ability of the US Competent Authority to reach a mutual agreement qua negotiating a settlement with the foreign competent authority, which will provide relief from double taxation, particularly when a contemporaneous bilateral or multilateral APA request would have been both effective and practical to obtain consistent treatment of the APA matters in a treaty country.” – Also See PwC, International Transfer Pricing 2013/14, supra, n. 213, p. 849.
a. Threshold **monetary limit** for applicability of APA – USD 10,000 to USD 50,000\(^{46}\)

b. Best **method** chosen by Assessee.

c. **Year** to be specified for the applicability of the APA.

d. Assessee to file application along with the federal income tax return.

e. **IRS to evaluate** the application after careful analysis of the data submitted

f. The IRS APA team & the Assessee to agree\(^{47}\) on a **case plan** to agree upon case milestones and dates for resolution.\(^{48}\)

g. Application if accepted, **written agreement** to be signed between the Assessee & IRS.

The **Revenue Procedure 2008-31**\(^{49}\) amended the APA, modifying the scope of the APAs from the restricted latitude of the yesteryears transfer pricing issues arising within the context of section 482 of the Internal Revenue Code, towards expanding it in the direction of including ‘*attrition of profits to permanent establishment (PE)*’.

The expansion of Section 482 to such a PE (becoming a PE under the aegis of a Double Tax Avoidance Treaty (DTAA)), assists in the Revenue authorities in the determination of –

a) The income generated which can be linked with the US Assessee’s business activities carried on within the US territorial boundary;

b) As also the income generated by the US Assessee’s business activities spawning from activities originating partly within the US territorial boundary and partly outside;

c) It also includes income generated through related-subsidiary issues.\(^{50}\)

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\(^{48}\) Failure by the taxpayer to meet its obligations under the case plan may suitably result in the IRS treating the APA request as withdrawn.

\(^{49}\) Made effective from 9 June 2008.

\(^{50}\) PwC, *International Transfer Pricing 2013/14, supra*, n. 213, p. 842.
5.1.6.1 2006 Competent Authority Process

The Indian APA provisions are more or less on a similar footing compared to the United States APA revenue procedure, except few procedural and monetary limits differences, but what it lacks is an alternative preliminary option as provided under the US TP Regulations known as the Competent Authority Process.

This is only applicable in the US, and India does not have it; BUT its suggested to be made a part of the Indian TP regulations because of its positive impact being an alternative pre-litigation option; the OECD Guidelines should also make a provision to include this in their Guidelines.

United States in 2006 came up with this new procedure, referred to as the competent authority process, which the assessee may invoke in cases where the assessee believes any detrimental impact of a newly concluded tax treaty on an existing Double Taxation Tax Treaty (DTAA).

The assessee can avail of this alternate option without first having to seek a review of those issues on which there is no consensus in the US between the IRS Appeals Division and the Assessee OR under an Advance Pricing Agreement.

Section 12 of the Revenue Procedure, deals with such request, and its consequential reasons for acceptance or denial, as specifically enumerated under the section.

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51 Time and cost savings as per the Indian APA rules (prescribed form (Form No3CED)): An APA typically gets resolved or agreed in one to two years and could provide protection for up to five years (nine years in case of roll back), and will be renewed after the period providing time and cost savings as compared to protracted domestic litigation which could take as much as 10–12 years to reach the final verdict by the Apex court, onerous compliance documents and rigorous TP audits.


53 Ibid, at p. 839 – "With the exception of the treaty with Bermuda, all US income tax treaties contain a Mutual Agreement Article that requires the competent authorities of the two treaty countries to consult with one another in an attempt to reduce or eliminate double taxation that would otherwise occur when the two countries claim simultaneous jurisdiction to tax the same income of a multinational enterprises or an affiliated group. The Mutual Agreement Article contained in US tax treaties does not require the competent authorities to reach an agreement eliminating double taxation in a particular case. Rather, the treaties require only that the competent authorities make a good faith effort to reach such an agreement. Competent authority agreements may be extended to resolve similar issues in subsequent tax years."
5.2 UNITED KINGDOM

Her Majesty’s Revenue and Customs (HMRC), the United Kingdom's tax authority continues to focus on effective compliance of the tax and transfer pricing provisions. HMRC has put in place a process to discuss transfer pricing issues before a tax return is submitted and continues to offer certainty by way of APAs. HMRC aims to finish any TP enquiries within a period of 18 months or 36 months depending upon the complexity of the enquiry) and in doing so it applies a risk-based approach, pursuing the high-risk transactions. Recent scrutiny of the transfer pricing of some large multinationals by the Government’s Public Accounts Committee and increased funding by the Treasury for HMRC’s transfer pricing specialists is expected to lead to increased examination of transfer pricing arrangements in the UK in 2017-2018.

5.2.1 TP Regulations & Rulings

The extant 54 Transfer Pricing Rules form part of TIOPA 55 2010. Parts 4 and 5 of the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010), incorporates the principal UK transfer pricing legislation. TIOPA 2010 was incorporated as a part of the UK government’s tax law rewrite project and expounded a restatement of all the previous provisions provided, *inter alia*, under Schedule 28AA of ICTA (Income and Corporation Taxes Act) 1988, which became applicable from 1 July 1999 to 1 April 2010. 56 The central government agency having the primary responsibility for enforcement of the transfer pricing rules is the Her Majesty’s Revenue and Customs (HMRC). The Assessee and the revenue Department are also guided by the transfer pricing rules, provided under Schedule 28AA & section 770A of the Corporation Taxes Act, 1988. 57 The HMRC also publishes its internal guidance on its official website, apart from publishing technical notes and Statements of Practice in re transfer pricing issues. 58

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54 effective from 01.04.2010


57 Several amendments have been carried out to the same thereafter.

Similar to the US regulations, UK follows the same approach of making the 
transfer pricing regulations applicable to ‘all related party transactions’ once the 
following threshold conditions are met:

The consistency of the UK transfer pricing legislation with the OECD Guidelines is 
secured under Section 164 TIOPA 2010, which expressly endorses such interpretation 
of the provisions. It states that the TP provisions apply to :

(A) A ‘provision’ has been made or imposed between two persons by means 
of a transaction or series of transactions;

(B) One of those persons was directly or indirectly participating in the 
management, control and capital of the other; or the same person or persons 
were directly or indirectly participating in the management, control and 
capital of both parties to the provision;

(C) The actual provision differs from the arm’s length provision which would 
have been made between different enterprises; and

(D) That difference gives rise to a potential UK tax advantage.

In earlier years before the introduction of the self-assessment procedure\textsuperscript{59}, it was not 
obligatory upon the assessee to adopt the arms length price, except where a specific 
direction from the HMRC was issued.\textsuperscript{60} Now of course every assessee has to comply 
with the transfer pricing regulations by identifying such transactions and making 
appropriate adjustments to reach the ALP at the time of filing their returns.

The applicability of the regulations in cases of related party transactions includes 
where one enterprise either controls the other enterprise or both the 
enterprises/entities are under a single common control. The threshold for transfer 
pricing rules to apply between parties ranges between 40 percent\textsuperscript{61} and 50 percent 
Ownership;

\textsuperscript{59} Similar to the US self-assessment procedure followed by the IRS. 
\textsuperscript{60} Wahi, 5th ed., 2013, supra, n. 12, p. 768. 
\textsuperscript{61} Part 4 of the TIOPA 2010.
The word ‘Control’ is defined under Section 1124 of the CTA 2010.62

“Control (1) This section has effect for the purposes of the provisions of the Corporation Tax Acts which apply this section (or to which this section is applied). (2) In relation to a body corporate (“company A”), “control” means the power of a person (“P”) to secure— (a) by means of the holding of shares or the possession of voting power in relation to that or any other body corporate, or (b) as a result of any powers conferred by the articles of association or other document regulating that or any other body corporate, that the affairs of company A are conducted in accordance with P’s wishes. (3) In relation to a partnership, “control” means the right to a share of more than half the assets, or of more than half the income, of the partnership.”63

As seen here, ‘Control’ is not restricted to the usual one entity being majority shareholder in the other instance but also enlarges the scope to ‘effective control’ wherein one entity exercises the power to warrant the affairs of another entity to be conducted in accordance with the terms as provided by the said first entity. PwC64 rightly provides that the concept of control as set out under Section 1124 is subject to important extensions qua TP adjustments under Part 4 of the TIOPA 2010,65 –

• “The rules apply to any joint venture companies where two parties each have an interest of at least 40%.

• Attribution rules are used to trace control relationships through a number of levels in determining whether parties are controlled for the purposes of the transfer pricing rules.”66

Part 4 of the TIOPA, 2010 and the Schedule 28AA do not capture within its ambit transactions occurring between a UK company and its own branch and/or a permanent establishment; which is in stark contrast with the Indian TP regulations where a permanent establishment (PE) is defined as part of an ‘Enterprise’ 67.

62 Formerly Section 840 under the ICTA 1988.
63 Interestingly, in re ‘financial deductions’ the UK provisions also provide for a novel concept of ‘acting together’, w.e.f. 04.03.2005.
64 PwC, International Transfer Pricing 2013/14, supra, n. 213, p. 793.
65 Formerly ICTA 1988, Schedule 28AA.
66 Ibid.
(which if and when proven to be an ‘Associated Enterprise’\textsuperscript{68}), would be subject to the Indian transfer pricing rules.

TIOPA 2010, Part 4\textsuperscript{69} is not applicable to the transactions between the Assessee enterprise and its PE or branches, and the law does not treat them as two separate legal entities. “Instead, other sections of the legislation as well as the ‘Business Profits’ article of the relevant DTA operate to tax the appropriate amount of profit in the UK...In the case of a UK branch or permanent establishment of an overseas company, income arising directly or indirectly through or from the branch remains taxable in the UK under CTA 2009.”\textsuperscript{70}

That having been said, an overseas branch/PE of a UK resident company may well fall within the mischief of these provisions and consequentially the UK corporation tax may well become applicable to the branch/PE.\textsuperscript{71}

\textbf{Both the Indian and UK transfer pricing regulations borrow the definition of Permanent Establishment (PE) from the OECD guidelines, since neither of the countries have defined the same under their respective statutory provisions.}\textsuperscript{72}

The definition captures within it any fixed place of business and/or agents/agency acting on behalf of the overseas company\textsuperscript{73}; and excludes any entity merely rubber-stamping the decisions of the overseas company and/or carrying on only preparatory or auxiliary functions.

\textsuperscript{68} As per Section 92A of the Income Tax Act, 1961
\textsuperscript{69} Formerly ICTA 1988, Schedule 28AA.
\textsuperscript{71} Provisions for the same introduced by the Finance Act, 2003; Few limited exemptions are provided to certain cases of small and medium-size enterprise/s (SMEs); In fact, SMEs are not required to apply transfer pricing unless (i) they elect to do so (which can be done only irrevocably), (ii) they transact with an affiliate in a ‘non-qualifying’ territory (broadly, a territory which does not have a ‘full’ double tax treaty with the UK), or (iii) they receive a notice from HMRC requiring them to apply transfer pricing; See Slaughter and May, \textit{Transfer Pricing 2016 United Kingdom}, LAW BUSINESS RESEARCH LTD., October 2015, at p. 4.
\textsuperscript{72} Though recently in 2014 a definition of permanent establishment has been brought into the act under 92F (iiia) of the act, on the same lines as the OECD Guidelines 2010 (supra, n. 67).
\textsuperscript{73} Not just merely rubber-stamping their decisions, but acting on their independent volition in certain given circumstances or all.
There is no gain in saying that obviously the law provides that any such transactions between the assessee and such a Permanent Establishment have to be necessarily at arm's length. Examples would include disallowance of deduction in re any payment/s of Royalty or any such relatable fee/s made by the PE to the Assessee for use of the intangible asset, ownership of which lies with the UK resident assessee.

It is extremely germane to point out that the UK TP Rules follow the ‘one-way street approach’, i.e. where in the course of carrying out the TP analysis, if the Assessee makes a detrimental\textsuperscript{74} TP adjustment, it would be allowed, but where it is beneficial for the assessee, it is impermissible.\textsuperscript{75} This is a common approach followed by other tax authorities in other jurisdictions like India and USA as well. Fortunately or unfortunately, as the case may be, no such case has come up before any of the courts and therefore no judicial ruling exist on the same.

Apart from codified legislation on the subject, for further guidance periodically updated HMRC Manuals are prepared and are available for internal use by the Department.\textsuperscript{76} Furthermore, The Practical guidance on transfer pricing covers the following main areas:

- Governance.
- Risk assessment.
- Working an enquiry.
- Examining TP reports.
- Gathering evidence.
- The interaction with direct taxes.

**Arm’s Length Principle (ALP) & TP methods used**

The choice of UK methods are entirely similar to those applied in India –

1. Comparable Uncontrolled Price Method
2. Resale Price Method
3. Cost Plus Method
4. Comparable Profits Method

\textsuperscript{74} That is where the result is increased taxable profits or reduced allowable losses in the UK.

\textsuperscript{75} That is where result is decreased taxable profits or greater allowable losses.

\textsuperscript{76} Notably, some of the TP provisions of the International Manual were substantially rewritten in 2012.
5. Profit Split Method

6. Other Method/s

Though as such there are no preferred methods like in India in line with the OECD TP Guidelines 2010, but the HMRC provides that the general traditional transaction methods are to be applied followed by transactional profit methods; and the comparable uncontrolled price (CUP) is one of the preferred methods for determining the ALP, wherever comparable uncontrolled transactions can easily be documented and verified.

Reiterating at the cost of repetition, adjustments are carried out under schedule 28AA of ICTA1988, in the same manner as under the Indian and US TP regulations, between related parties/associated enterprises, where of course the transactions are not within the arm's length range.

Pertinent to note here in is that there are no specific provisions or rules which provide for the modus operandi for carrying out these adjustments, which constitutes a huge void since it leads to disparity in the manner of applying these methods to a given set of international transaction/s. Once an adjustment is made by the tax authority to profits under schedule 28AA, it cannot then further additionally make any increases (sic) to the price to be offered to the UK taxpayer or issue of refund for reduced price.77

Needless to add, that since the UK follows the self-assessment procedure, the primary obligation to make adjustments, if any, to the price or income lies solely on the assessee. One of the important exceptions provided under the UK TP rules is that adjustments would not be allowed even though the transaction is a non-arm's-length transaction if it does not consequentially resulting in any tax advantage in UK.78

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77 Wahi, 5th ed., 2013, supra, n. 12, p. 771; Moreover, there is no scope for any secondary adjustments available to the HMRC.

78 ibid, p.771; Though, Adjustments for any consequent double taxation (which may arise from under another country jurisdiction’s TP Regulations) can be provided if requested for and proven therein; There is a time limit (at least six years) on pursuing the MAP. The UK has an extensive double taxation treaty network, with over 100 treaties, including treaties with all of the world’s 50 largest economies other than Brazil and Iran. Most of these treaties have effective MAPs.
5.2.2 Jurisprudence

The United Kingdom is not fraught with litigation which is quite opposite to the Indian scenario almost all transfer pricing cases end up in litigation. The resolution mechanism for the transfer pricing disputes in the UK is mostly through negotiations between the assessee and the HMRC, under a more collaborative umbrella. This is quite contrary to the Indian transfer pricing milieu where transfer pricing adjustments are one of the most litigated issues.

The perception did undergo a brief change from collaborative to litigational following the publication of the **Litigation and Settlements Strategy (LSS)** by HMRC. But experience has shown the litigational approach to be restricted to the “tax avoidance” cases, and in fact prescribes that – “where possible, issues should be resolved in non-confrontational and collaborative ways without entering into a dispute.”

HMRC’s recent Report titled “Improving Dispute Resolution” provided 35 recommendations and its 2009 establishment of the Business International Division (BID) in January 2009 with the responsibility of especially addressing international transfer pricing issues, adds fuel to the collaborative approach adopted by the HMRC in TP disputes.

One of the few rare occasions where the matter entered into the adjudicatory arena was in the landmark judgement of *DSG Retail v HMRC* delivered on 23 April, 2009.

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*DSG Retail v HMRC*

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80 See *ibid*, LSS paper (paragraph 5).

81 The hearing lasted 15 days.
The case involved substantial application of the transfer pricing regulations and provisions and the OECD Guidelines, ascertaining the appropriate TP method for making a transfer pricing adjustment. The facts of the case surrounded on the issue of sales commission. DSG, one of the largest retailer of electrical goods in the UK had a subsidiary, CIS which further acted as an agent for Cornhill Insurance plc (Cornhill) and offered DSG’s customers extended warranties on electrical goods, in return for which Cornhill paid CIS a sales commission. What caught the eye of the HMRC was that Cornhill was retaining 5% of the risk and reinsuring 95% of the risk with DISL, a subsidiary of DSG, incorporated in the Isle of Man, even though there was no privity of contract between DSG and DISL directly. This, the HMRC contended, resulted in a large proportion of the profits accumulating in the Isle of Man subsidiary, DISL, on which no tax in the UK was being paid. The major issues, which arose for determination, were –

1. In light of **NO direct contractual relationship could the TP provisions be made applicable.**
2. Applicability of Schedule 28AA ICTA to the arrangement between DSG & DISL.
3. Did the arrangement result in conferment of a potential advantage in relation to UK tax.
5. TP methodology to be used.
6. Selection of the appropriate ‘tested party’ for benchmarking this transaction.

83 Also referred to as the Dixons case since it concerned the sale of extended warranties to third-party customers of Dixons, a large retail chain in the UK selling white goods and home electrical products.
84 The earlier cases involved adjudication only on procedural and interpretative issues – Watson v Hornby (1942), Sharkey v Wernher (1955) and Petrotim Securities Ltd v Ayres (1963), established the principle of arm’s-length prices for transactions between related parties as now embodied in the legislation; See PwC, International Transfer Pricing 2013/14, supra, n. 213, p. 796.
85 Chelsea Roche, Landmark case on UK transfer pricing rules: DSG Retail v HMRC, 23 July 2009, Bird & Bird LLP, <https://www.twobirds.com/en/news/articles/2012/landmark-case-uk-transfer-pricing-rules> last visited on 14.12.2015; HMRC sought to bring a larger share of the profits into charge in the UK by invoking the transfer pricing rules and contending that the arrangements were not consistent with the arm’s length principle.
86 And also section 770 ICTA, since the period under enquiry included years prior to the introduction of Schedule 28AA ICTA – Benefit conferred upon DISL represented the giving of a ‘business facility’ (under ICTA s 770 (which applied in respect of the period 1996/97 to 1998/99)) or a ‘provision’ from DSG Retail (under ICTA Sch 28AA (which applied from 1999/00 to 2003/04)).
The Special Commissioners (First Tier Tax Tribunal) ruled on the applicability of the TP provisions to the transactions in the affirmative and held that Section 770 of ICTA 1988 and Schedule 28AA were fully applicable to the particular series of transactions and – “essentially the phrases ‘facility’ (Section 770) and ‘provision’ (Schedule 28AA) were interpreted broadly so that there was something to price between DSG and DISL, despite the insertion of a third party and the absence of a recognised transaction between DSG and the other parties involved.” 87 And for this a corresponding fee had to be levied and should have been paid by DISL, having regard to the risks undertaken and functions performed by DISL. 88

The Tribunal rejected the Assessee’s choice of comparables in re similar contracts based on DSG’s 89 position –

- Being a strong powerful brand
- DSG’s point-of-sale advantage being the largest retailer of domestic electrical goods in the UK. 90
- DSG’s point-of-sale advantage as per DSG’s past claims data.
- The powerful brand providing extended ‘off-the-shelf’ warranty cover through disparate distributors.
- Looking at the market return on capital of DISL.

The First Tier Tax Tribunal concluded that this advantageous bargaining power of DSG gave rise to SUPER PROFITS, these which need to be necessarily distributed between the concerned enterprises proportionately as per their normal competitive forces and each party’s bargaining power.

Apart from the bargaining power the Tribunal, while rejecting the CUP method and comparables chosen by the Assessee, also observed that the time, product, termination

89 Third-party re-insurer.
90 The Tribunal also noted that DSG had a strong brand, powerful point of sales advantage through access to customers in their shops and could easily have sourced the basic insurance provided by DISL elsewhere; ibid, at p. 798
contract term and the Extended Warranties clauses in the comparable contracts were very different. The Tribunal further validated the use of profit based methodologies, while employing the PSM method in the case herein, and affirming its application in cases where reliable comparables cannot be found.

The contentions and judgment surrounding the term ‘provision’ under (Schedule 28AA) must also be seen in the light of the new legislation – wherein as per Section 147(1)(a) TIOPA 2010 – which is made applicable in cases where a “‘provision ... has been made or imposed as between any two persons ... by means of a transaction or series of transactions, which is different from the arm’s-length provision that would have been made between independent parties.”91 The term of art ‘provision’ is much wider under the new legislation as compared in the same sense of term or condition in a contract.92

This term ‘provision’ as provided under the UK TP rules can be related to the factor of ‘contractual term’ which assumes importance under the Indian Transfer Pricing Regulations and is considered an important factor while conducting the comparability and FAR analysis during the adoption of the transfer pricing method.

**Waterloo plc93 and other v IR Commrs (2001)**

This was another UK TP case in the new millennium where the Special Commissioners held that a tax should be leviable on Waterloo plc for providing in a way share benefits to the employees of the subsidiaries for them to participate in the option arrangements. This was termed as a ‘business facility’ and required an upward transfer pricing adjustment to Waterloo’s taxable profits.

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91 Peter Nias, *Transfer Pricing and Dispute Resolution—The U.K. Experience*, INTERNATIONAL TAX JOURNAL, September–October 2010, CCH, at p. 26
92 *ibid*, at p. 27. See Section 147(5) TIOPA 2010; In such a given situation, “the profits or losses of the U.K. person who has benefited as a result should be computed as if the arm’s-length provision had been made.”
93 The name of the company was kept undisclosed.
The Court rejected the assessee’ arguments on the inapplicability of Section 770 on the ground of no direct privity between Waterloo and the employees of the subsidiary, but instead being between the share scheme trustee and Waterloo plc.

It held that as per the provisions of the UK transfer pricing regulations - Section 770 of the ICTA 1988, requiring a ‘giving’ of facilities to a recipient, - which in this case was done by providing remuneration to the employees of the subsidiaries for the clear and valuable benefit incurred by them under this ‘business facility’. Paragraph 57 of the judgement highlights the use of the phrase ‘business facility’ in the sense of a commercial and not as a legal term and held that – “where a commercial term is used in legislation, the test of ordinary business might require an aggregation of transactions which transcended their juristic individuality”.

*Rochester (UK) Limited and Another v Pickin (1998)*

Another early case in the late 1990s was that involving the UK subsidiary of Rochester Canada. The transactions involved are depicted in the following Figure 5.4.

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95 Persons not under common control.
96 As amended by Section 773(4).
97 PwC, *International Transfer Pricing 2013/14*, supra, n. 213, p. 797; “On a wider level, the case provides a presumption that ICTA 1988, Section 773(4) allowed the Revenue to tax the total facility provided intra-group and did not require a transaction-by-transaction analysis.” “The Revenue issued guidance on its view of this case and, subsequently on the application of the arm’s-length principle to share plans in light of the accounting rules for share-based payments under IFRS, which apply to accounting periods beginning on or after 1 January 2005.”
The Court held in the assessee’s favour, and rejected the Revenue Department’s contention that – payments made by the assessee to the Appenzell Swiss Co. for the medical research center, were actually made for zero consideration.100 Since the department had failed to discharge the burden of showing any tax avoidance technique being put to use, the payments made by the UK assessee were taken on its face as part of the commercial arrangement made wholly and exclusively for the purposes of and in facilitation of its trade and business101.

Both these cases indicate towards the court’s intention to apply the transfer pricing Regulations or the international transactions only where the HMRC has fully and completely discharged the initial burden. This is done so as to deter the Department from making those transfer pricing adjustments in the first place that may lead to contentious litigation – advancing the collaborative and non-litigation approach under the UK transfer pricing regime.

100 ibid, at p. 28
101 As within the meaning of the Corporation Taxes Act, 1988, s74 (1)(a)
5.2.3 Documentation Requirements

The UK provisions and regulations pertaining to transfer pricing do not contain any specific rules requiring any specific documentation\(^{102}\). This is by far one of the biggest differences between the UK transfer pricing regime on documentation on one hand and the majority of the countries (like India, US, South Korea, etc.) along with the OECD guidelines on the other hand.

The general self-assessment rule have to be adhered by the Assessee for carrying out any related party transactions – which Rule “requires taxpayers to keep and preserve the records needed to make and deliver the correct and complete return”\(^{103}\).

The International Manual on the record keeping requirements incorporates the HMRC guidance in relation to the Assessee for maintaining accounting and tax records, for filing of the tax return for the relevant assessment year\(^{104}\).

In cases where HMRC initiates any TP enquiries, all the relevant documents pertaining to the said transaction in question would mandatorily have to be preserved for six years. Consequential to such enquiries, the relevant information and documentation requisite, may include but is not limited to –

i) The nature of the transaction;

ii) Method used and ALP determined after testing comparability on the anvil of the FAR analysis comparative;

iii) Commercial or financial arrangement in controlled and uncontrolled transactions with third parties;

iv) Any other material information especially relevant for the purpose of disclosure.

As stated above, the UK Transfer Pricing legislation does not provide for the submission of any specific documentation except those which are to be necessarily filed along with the tax returns by the assessees. The contemporaneous transfer pricing documentation maintained by the assessees can help it avoid penalties leviable in cases

\(^{102}\) except for the general documentation to be maintained by every assessees irrespective of having any International transaction requiring transfer pricing adjustment.

\(^{103}\) Wahi, 5\(^{th}\) ed., 2013, supra, n. 12, p. 776.

\(^{104}\) ibid, p. 776.
of inaccurate tax return caused by careless (or deliberate) conduct\textsuperscript{105}, which gets offset by the reasonable belief with which the assessee has carried out the TP analysis in the tax return.

The **HMRC under its general information powers\textsuperscript{106}** can ask for this information **by issuing** a written notice to the assessee who is given a reasonable period of time to produce the said documents and relatable information.\textsuperscript{107} In cases where there is a specific request or query made by the HMRC seeking information in relation to any enquiry qua the Assessee’s TP obligations, the assessee must provide at least the FAR analysis, addressing the functions, assets and risks in the UK *as compared to those belonging to other parts of the business*.\textsuperscript{108}

**HMRC’s Internal Guidance in its International Manual** provides the record-keeping requirements. Basically HMRC prescribes four classes qua these record-keeping requirements to be taken into account as follows –

1. Primary accounting records\textsuperscript{109} –
2. The tax adjustment records\textsuperscript{110}
3. Associated businesses or subsidiary businesses transactions records.
4. The evidence used and applied to arrive at the arm’s-length price.

The Global Reference Guide by E\&Y\textsuperscript{111} further interprets and elaborates on these requirements, and states that in consonance with the OECD Guidelines, HMRC suggested inclusion of the following information –

\textsuperscript{105} Almost similar to the Indian Penalty levy under Section 271(1)(c) of The Income Tax Act, 1961, for providing ‘inaccurate particulars’ and/or ‘deliberate concealment’.
\textsuperscript{106} Under Finance Act (FA) 2008, S. 113 read with Schedule 36, Introduced with effect from 1 April 2009.
\textsuperscript{107} PwC, *International Transfer Pricing 2013/14*, supra, n. 213, p. 802 “The person receiving the information notice may appeal against it, unless the notice is to produce the statutory records that the person is obliged to keep or if the tax tribunal approved the issue of the notice.”
\textsuperscript{108} Slaughter and May, 2015, supra, n. 279, p. 4. “There is no requirement to produce UK-specific evidence, so global, regional or non-UK transfer pricing reports may be accepted.”
\textsuperscript{109} Documents in relation to the Transactions.
\textsuperscript{110} Documents in relation to identifying Adjustments.
\textsuperscript{111} E\&Y, 2012 *Transfer Pricing Global Reference Guide*, supra, n. 266.
“An identification of the associated enterprises with whom the transaction is made
A description of the nature of the business
The contractual or other understandings between the parties
A description of the method used to establish or test the arm's length result, with an explanation of why the method is chosen
An explanation of commercial and management strategies, forecasts for the business or technological environment, competitive conditions and regulatory framework”

In furtherance of, the OECD BEPS Action plan 13\textsuperscript{112} issued in September 2014 qua the CbC Reporting\textsuperscript{113} provision adopting a \textit{three tiered approach} towards documentation, the United Kingdom has carried out the necessary amendments vide its Finance Act 2015, by introducing the ‘Diverted Profits Tax legislation’ and the ‘Taxes (Base Erosion and Profit Shifting) (Country-by-Country Reporting) Regulations 2016’, and has already incorporated the BEPS three-tier documentation into its local legislation.

This is a huge step towards transfer pricing singularity and providing for a uniform set of TP provisions.

**EU European Union guidance on transfer pricing documentation**

In June 2006 the Council of the European Union agreed to a code of conduct on associated enterprises in the European Union of which United Kingdom is a part of. Of course it is quite uncertain if post-Brexit the United Kingdom would follow the EU guidance which is mostly in line with the OECD CbCR provisions.

\textsuperscript{112} supra, n. 50.
\textsuperscript{113} Country by Country Reporting.
5.2.4 Disputes / Litigation

The first line of courts in case of any dispute between the assessee and the tax department is through an appeal\(^\text{114}\) to the First-tier Tribunal. Unlike in India the transfer pricing litigation is extremely rare in UK and only few cases have so far have reached with the tribunal stage\(^\text{115}\). Most reliefs are acquired, in the cross-jurisdictional cases, through the DTAAAs and MAP procedure established between the UK and the other country. As per the Indian transfer pricing regulations the forum for transfer pricing disputes is the Dispute Resolution Panel (DRP) as provided under Section 144C of the Income Tax Act.

The alternative available to the UK assessee to the dispute settlement through the Tribunal, is the power to seek review from HMRC under the aegis of Section 49A of the Tax Management Act 1970. **NO such power of review from the income tax authority is provided under the Income tax act.**

Under section 49E of the Tax Management Act 1970, the review may result into HMRC\(^\text{116}\) choosing to either uphold, vary or cancel its original view on the issue.\(^\text{117}\)

The assessee may choose to appeal any adverse review order of the HMRC before Tax Tribunal within the appeal time-limit of 30 days; failure to exercise this choice will result into a deemed acceptance of the review order.

The consequences of this review process are three-fold – i) HMRC upholds its original stance, ii) HMRC makes a minor or substantial variation iii) or in light of the review outrightly cancels its stance. Having taken any of these recourses, the Assessee needs to be notified of such a consequence within the time-limit of 45 days, or any other such agreed period as envisaged under section 49E of the TMA 1970).\(^\text{118}\)

If & where the HMRC’s review is **unfavorable**, and the assessee chooses to NOT accept it, the assessee has to mandatorily file an appeal before the Tax Tribunal to contest the same, within a 30 days time-limit; where the assessee fails to do so the HMRC’s review conclusions would be deemed as agreed.

\(^{114}\) Usually in cases of an open enquiry or HMRC having issued a closure notice, amended the taxpayer’s return or made a ‘discovery’ assessment.

\(^{115}\) Discussed above, *supra*, n.

\(^{116}\) To be notified to the assessee within 45 days.


\(^{118}\) *ibid*, at p. 803.
5.2.5 Arbitration

A niche area not explored by any other jurisdiction (except UK and EU) is that of solving transfer pricing disputes through Arbitration.\(^{119}\) This of course was before Brexit\(^{120}\), when UK being an EU member was a signatory to the Arbitration procedure of the EU Arbitration convention. Now the adoption of the same depends upon the nature of the agreement that gets signed as a consequence of invoking of Article 50 of the Lisbon Treaty. Prior to Brexit, the EU convention gave this option of a *mandatory arbitration procedure* in cases where there was no mutual agreement for two years.

Though there is no fixed modus-operandi for conducting the Arbitrations and are to be shepherded on a case to case basis; the main procedure consisted of an *Advisory Commission*, which included independent experts who were bound to give their opinion within a specified timescale. The procedure entails 2 options for the tax authorities of the 2 countries –

a) Either comply with the Advisory Commissions’ mandate, or,

b) Choose recourse to another mode of dispute resolution, which would have to be mandatorily done within a period of six months.\(^{121}\)

Recently, such dispute-settlement mechanisms of Arbitrations with consequential Advisory Commissions’ opinions, now found mention in most of the double tax avoidance treaties between the UK and France, Germany as also the Netherlands.\(^{122}\)

\(^{119}\) Only where the concerned assessessees decide in the UK and/or European Union.


5.2.6 Advanced Pricing Agreements (APAs)

The APA legislation is contained in Section 85 to 87 of the Finance Act 1999, which was later rewritten\textsuperscript{123} as Sections 218-230 of the TIOPA 2010 (Part V)\textsuperscript{124}. Guidance for interpretation and concrete application of the new APA legislation was provided vide the new Statement of Practice (SP) SP2/10. The UK APA program commenced in 1999\textsuperscript{125} and is today one of the most well-established and efficacious programs across the globe.\textsuperscript{126}

Like US, India & other countries, the APAs are either unilateral, bilateral or multilateral; Though the preference for the UK Assessors is bilateral APAs, but the one of the significant changes\textsuperscript{127} brought about in the HMRC’s new statement\textsuperscript{128} is encouragement for a greater number of Unilateral\textsuperscript{129} APAs. Once the agreement is concluded, the Assessor loses the right to withdraw. The HMRC does have the authority to reject an Assessors’ APA request but only after the assessee has been granted the opportunity of being heard, and issuing formal statement containing the reasons for rejection.

The time period for the APA is determined in the agreement itself, though HMRC expects most APAs to last for a maximum period of five years. The APA will apply prospectively for the assessment years subsequent to the application, although HMRC does allow ‘roll-back’ of APAs in certain given circumstances.\textsuperscript{130}

\textsuperscript{123} As part of the UK's Tax Law Rewrite Project.
\textsuperscript{124} Taxation (International and Other Provisions) Act 2010.
\textsuperscript{125} Prior to this date, the APAs were agreed using the MAP mutual agreement procedure of the relevant DTAA.
\textsuperscript{127} In addition to relaxing the ‘complexity’ threshold for accepting APA applications.
\textsuperscript{128} Superseding SP 3/99.
\textsuperscript{129} “in the new Statement it recognises that unilateral APAs may be agreed in certain circumstances such as where the other side of the transaction does not have a formal APA programme, or where the conclusion of a bilateral agreement would provide little additional benefit to either party.” See in this regard PwC, International Transfer Pricing 2013/14, supra, n. 213, p. 808.
\textsuperscript{130} PwC, International Transfer Pricing 2013/14, supra, n. 213, p. 809.
Section 218(1) of the TIOPA 2010\textsuperscript{131}, is the initiation section for filing the application under the statutory provisions. The procedure for APA with the typical steps is as follows –

1. The APA process is initiated by the assessee
2. A Pre-Filing ‘Expression of Interest’\textsuperscript{132} and meeting with HMRC
3. Filing of a formal application to the HMRC
4. Evaluation of the application by HMRC\textsuperscript{133}
   i) Check the TP methodology used.
   ii) Several rounds of discussions between HMRC & the Assessee
   iii) Exchange of information
   iv) Negotiation With Taxpayer
5. Final mutual agreement between the Assessee and HMRC.
6. Filing of Annual APA Report\textsuperscript{134} demonstrating whether the Assessee has complied with the terms and conditions of the APA.

The formal application by the Assessee must include, \textit{inter alia}, the following –

- Enterprises involved
- TP issues arising
- Documents in support of methods proposed
- ‘Critical assumptions’ made by the Assessee\textsuperscript{135}
- Assessment period/years
- Group structure (if and where applicable)

\textsuperscript{131} Formerly Section 85(1)(c) of Finance Act 1999.
\textsuperscript{132} “The \textit{Expression of Interest} presentation or meeting should generally cover: (1) The nature of the transfer pricing issues intended to be covered by an APA; (2) Details of the tax residence of the parties involved and the importance to the wider business of the transactions intended to be covered; (3) If already decided upon, a description of the proposed TPM by which prices are to be set or tested;” See E\&Y, 2012 \textit{Transfer Pricing Global Reference Guide}, supra, n. 266 – Chapter on guide to advance pricing agreements (APA): United Kingdom.
\textsuperscript{133} Differs in procedure for a unilateral APA & for a Bilateral APA.
\textsuperscript{134} See E\&Y, 2012 \textit{Transfer Pricing Global Reference Guide}, supra, n. 266 – Chapter on guide to advance pricing agreements (APA): United Kingdom. \textit{supra}, n. 340; The annual report is generally submitted with the business’ tax return. The particular requirements of each report are set forth in the finalized APA agreement and focus narrowly on the issue covered by the APA.
\textsuperscript{135} “Taxpayers also need to take great care over the 'critical assumptions’ in the APA. If these are breached, the certainty offered by the APA drops away entirely.” See Slaughter and May, 2015, \textit{supra}, n. 279.
Nature and details of any ongoing or pending tax enquiries and/or Competent Authority claims.

And any other relevant ancillary issues arising that is within the reasonable knowledge domain of the Assessee during the course of the suggested APA.

It must be noted that the HMRC has the leverage to use this aforementioned information for any other purposes apart from evaluating the APA request.

5.2.6.1 Pre-filing conferences

Under the UK framework, (as pointed at no. 2 of the APA procedure above) the initial contact regarding APAs is referred to as the Expression Of Interest process. HMRC strongly recommends that an interested Assessee enterprise makes an informal first contact with it prior to submission of a formal application.

The SP 2 Policy paper explicitly observes that this practice should be followed so as to “ensure that the resources of the business are not wasted on an unsuitable application and to ensure that the detailed work that will need to be undertaken by the business in finalizing (sic) its application is focused on relevant issues.”\(^\text{137}\) As per the HMRC it furthermore provides the HMRC “an opportunity to outline a realistic anticipated timetable for agreeing an APA based on past experience, or to discuss other practical ‘process’ issues with the business.”\(^\text{138}\)

Though the HMRC aims at completing the APA process between 12-21 months from the date of formal submission, One of the differences between a unilateral or bilateral APA is that, a unilateral APA is quicker, wherein the HMRC takes around nine months for Application evaluation followed by negotiations over the terms and detail of the APA; whereas in a bilateral case the procedure may extend to

\(^{136}\) For Large Business taxpayers, this may be done through their customer relationship manager at HMRC


\(^{138}\) Ibid.
beyond nine months.\textsuperscript{139} (See Figure below). According to HMRC in the year 2013/2014, half of the APAs were formally agreed to within a time span of about 19.7 months, which was up by 4.7 months from the previous year.\textsuperscript{140}

\textbf{Figure 5.2}

\textit{Source: Advance pricing agreements: Removing uncertainty from transfer pricing, 2014, PwC, PricewaterhouseCoopers LLP.}

An APA request can be made by any of the following\textsuperscript{141} –

- "Any UK business, including a partnership, with transactions to which the provisions of Part 4 of TIOPA 2010\textsuperscript{142} apply (the UK transfer pricing rules)
- Any non-resident trading in the UK through a permanent establishment
- Any UK resident trading through a permanent establishment outside the UK"

Though the HMRC has not laid out any preference or categorisation for the cases to be taken up under the APA program but, usually those cases are taken for consideration which either have complex transfer pricing issues\textsuperscript{143} specially or where there is a high likelihood of double taxation or where there is ambiguity in regard to the implementation of the TP method and arm's-length price.\textsuperscript{144}

\begin{itemize}
\item \textsuperscript{139} \textit{Certainty in the uncertain world of Transfer Pricing}: Whitepaper on APA in India 2011, PwC, 2011, PricewaterhouseCoopers Private Limited.
\item \textsuperscript{140} Slaughter and May, 2015, supra, n. 279. “Also as per the HMRC statistics in the year 2013/2014 43 APA applications were made, of which 29 were eventually agreed. In 2012/2013 45 applications were made but only 27 were agreed.”
\item \textsuperscript{141} <Guide to advance pricing agreements (APA): United Kingdom, E&Y>
\item \textsuperscript{142} Formerly Schedule 28AA of ICTA, 1988.
\item \textsuperscript{143} APAs involve the adoption of transfer pricing methods, tested party’s international transactions both relatable to goods and services. The APAs may deal with all the issues arising therein or restrict its scope to an exclusive issue. See in this regard PwC, \textit{International Transfer Pricing 2013/14}, supra, n. 213, p. 809.
\item \textsuperscript{144} \textit{Ibid}, generally.
\end{itemize}
The United Kingdom along with the US are one of the key territories for the APA programs, and India & South Korea are one of the key growth jurisdictions having current focus, in re the APAs, as provided in the figure below.

![Where can you get an APA?](image)

*Figure 5.3
Source: Advance pricing agreements: Removing uncertainty from transfer pricing, 2014, PwC, PricewaterhouseCoopers LLP.*

### 5.2.6.2 Mutual Agreement Procedure (MAP)

Apart from the APA another procedure of mutual agreement procedure (MAP) exists, which is dealt under Sections 124 and 125 of the TIOPA 2010\(^{145}\), though it must be stated that there is no formal method prescribed for applying under the MAP in the UK and the HMRC does not take it as a formal alternative. Herein the HMRC may choose to debate with the other tax authorities\(^{146}\) to eliminate instances of economic double taxation. The designated competent authority for the MAP procedure is the CTIAA which handles those disputes as provided under MAP relating to any transfer pricing issues.\(^{147}\)

\(^{145}\) Formerly ICTA 1988, Section 815AA.

\(^{146}\) The real advantage in this process can be highlighted in cases where the competent authority cases are likely to be more copius, there meetings between the United States IRS, the local tax authority of Japan (National Tax Agency) and the DGI (Direction Générale des Impôts, France), assist in the resolution of mutual agreement cases.

5.3 SOUTH KOREA

The Republic of South Korea in the last few decades has become one of the hubs of cross-border international transactions. It is the inception point of one of the major electronic companies – SAMSUNG\textsuperscript{148}. The Korean transfer pricing regulations have been codified to plug any outflow of tax or profit shifting as a result of such increased international transactions.\textsuperscript{149} \textbf{The regulations follow the OECD guidelines and are based upon the arm's-length principle.}

5.3.1 TP Regulations

The advent of transfer pricing regulations came after the year 1996\textsuperscript{150} and has been amended on several occasions, the latest being January 2011. The latest being the most significant one which included the concept of ‘most reasonable TP method’ in dealing a downward adjustment in cases where transfer price exceed the arm's-length; apart from other amendments related to documentation and penalty provisions.

The Law for the Co-ordination of International Tax Affairs (LCITA) was brought in force on 6 December 1995\textsuperscript{151} and to reconcile the Korean Transfer pricing regulations with the internationally accepted TP Rules – the LCITA and the Presidential Enforcement Decree (PED) of the LCITA (PED of LCITA),\textsuperscript{152} went through substantial amendments in 2010 to reflect changes made to the OECD Guidelines, 2010.

\textsuperscript{148} Samsung Group is a South Korean multinational conglomerate headquartered in Samsung Town, Seoul.

\textsuperscript{149} As per the TP WEEK REPORT “the NTS reported that it expected to collect $13.8 billion more in taxes in 2014 compared with the previous year- an increase of 7.7%...and... A key area of collection pinpointed by the NTS is on transfer pricing transactions.”

\textsuperscript{150} 1\textsuperscript{st} January, 1996; Till this time any such transaction came to be governed by the CITL (Corporate Income Tax Law).

\textsuperscript{151} Thereafter supplemented by a Presidential Enforcement Decree (LCITA-PED) and an Enforcement Regulation (LCITA-ER), which were announced on 30 December 1995, and 30 March 1996, respectively.

\textsuperscript{152} The \textbf{Tax Law} is the \textit{Law for Coordination of International Tax Affairs (LCITA)} and the complementary \textbf{Regulations and Rulings} are the \textit{Presidential Enforcement Decree (PED of LCITA)}, Ministerial Enforcement Ordinance, Notice of NTS.
Articles 4 to 13 of LCITA and Notice 98-12 covers the transfer pricing law. Interpretative assistance came in the way of the basic tax rulings under the LCITA (LCITA-BTR) issued on 15 June 2004. The introduction of the LCITA changed the face of the Korean TP regime and put the TP compliance at top priority.

In one of the proactive steps towards convergence and uniformity of the transfer pricing regulations, last year the Korean government made an announcement in regard to the domestic incorporation of the OECD Base Erosion and Profit Shifting (BEPS) Action Plan/s through amendments to be carried out in the LCITA in 2016. Soo-Jeong Ahn, head of the international tax team at Yulchon LLC of Korea ecstatically said on this incorporation that “We’ll have more development on rules and specific issues that have not been previously addressed.”

Transactions which come under the purview of ‘International Transaction’ would be between two enterprises when either one is a non-resident. These regulations also extend to the transactions of any kind of ‘payments made to any overseas controlling shareholder, tax haven receipts and payments and offshore gifts’. The regulations also provide for the concept of ‘deemed international transaction’ as well as ‘deemed related parties’ and applicability of the TP laws to such transactions between such companies, as enshrined under the LCITA. As seen under chapter 2, India is the only other country apart from South Korea to have the concept of a ‘deemed international transaction’.

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153 Dealing with Transfer pricing methods and selection of comparables, etc.
154 2015.
155 But is still pending and awaits incorporation.
156 Soo-Jeong Ahn heads the Yulchon LLC firm’s international tax team and also a member of the firm’s corporate & finance and real property practice teams.
157 Leading tax firm in Korea.
161 Under comparison; the others being US, UK and Mauritius.
The concept of Associated enterprises\textsuperscript{162} is integrated into the Korean TP regulations by providing the relationship threshold for applicability of the TP regulations being “Ownership of greater than 50 percent of voting power and is under a common control\textsuperscript{163}”.

This is referred to as a ‘special relationship’ where one of such enterprise in question –

i) directly or indirectly owns 50% or more of the total shares of other enterprise; or

ii) has substantial control and common interests exist between both such enterprises.\textsuperscript{164}

The transfer pricing provisions also permit offsetting of transactions, in case there is a difference in contract price as compared to the arm’s length price, so long as they are made within the same assessment year and transactions are related to the same foreign enterprise.\textsuperscript{165}

The OECD BEPS Action Plan 13 propelled the latest amendments to the (LCITA-PED)\textsuperscript{166} qua the new CRIT\textsuperscript{167} requirements, on December 15, 2015, by Korea’s Ministry of Strategy and Finance (MOSF) (CRIT) to better align the transfer pricing documentation requirements in the LCITA.\textsuperscript{168} These will be applicable to i) Cross-border related-party transaction volume in excess of KRW 50 billion; and ii) Sales revenue in excess of KRW 100 billion.\textsuperscript{169} Though it must be noted that the CRIT requirements do not include CbCR\textsuperscript{170}.

\textsuperscript{162} As seen in the Indian context, 92A of the Income Tax act, 1961.
\textsuperscript{163} de facto control in substance.
\textsuperscript{165} Wahi, 5th ed., 2013, supra. n. 12, p. 742.
\textsuperscript{166} December 24, 2015, with effect from fiscal years beginning on or after January 1, 2016.
\textsuperscript{167} Combined Report of International Transactions
\textsuperscript{169} ibid.
\textsuperscript{170} Country By Country Reporting (introduced by OECD).
5.3.2 TP METHODS

Korea also applies the same 5+1 TP methods as India –

1) Comparable Uncontrolled Price Method
2) Resale Price Method
3) Cost Plus Method
4) Profit split method
5) Transactional Net Margin Method\textsuperscript{171}
6) Other unspecified methods

\textbf{Korea being the 29th member of the OECD, its TP regulations are largely based on the OECD Guidelines. One principal difference with the OECD guidelines is that as per LCITA, the traditional transactional methods, i.e. Comparable uncontrolled price method (CUP), resale price method (RPM), and cost plus method (CPM) take priority over the transactional profit methods, i.e. profit split method (PSM) and the transactional net margin method (TNMM).}\textsuperscript{172}

Here it is further interesting to point out that prior to the latest amendment in 2011\textsuperscript{173}, in contrast to India and OECD\textsuperscript{174}, the LCITA had restricted the choice of methods to the hierarchy as provided above, which subsequently got changed to the usage of the ‘most reasonable method’ after the amendment\textsuperscript{175}. The principle of the so-called pre-imposed priority in the application of the methods now stands removed.

\textsuperscript{171} NTS usually focuses on the interquartile range in a TNMM analysis, and where “the results of the tested party falls outside the interquartile range, the adjustments are made to the median of the comparables”. Global Transfer Pricing Review 2016: Recent Developments From Around The World, KPMG, 2016, KPMG International Cooperative at p. 251.


\textsuperscript{173} Effective from January 1, 2011.

\textsuperscript{174} Prior to 2010 even OECD gave preference to traditional methods (CUP, RPM, CPM) over the transactional profit methods (PSM and TNMM).

\textsuperscript{175} Amended as of 27 December 2010.
5.3.3 TP Adjustments

The NTS\textsuperscript{176} had been given the power to make necessary adjustments and/or recalculate the tax base in light of the arm's length price reached. The Transfer pricing adjustments as a separate adjustment item is allowed to be made in the income tax return, though the adjustment may not be reflected in the books of account. The \textbf{Korean TP provisions provide for self-initiated adjustments} as well as amended tax returns which may be filed within three years of filing the original return\textsuperscript{177}. \textit{This provision of allowability of a self-initiated adjustment is a black sheep amongst the other transfer pricing provisions of the Korean TP regime which are mostly common with the other jurisdictions and in line with the OECD guidelines. Nowhere else is such a self initiated adjustment allowed.}

The Korean legislature also made appropriate changes in 2010 to include the combined transactions approach, i.e. aggregation of individual transactions, wherein separate transactions being so inextricably linked with each other that it would be better and more appropriate to combine these transactions for applying the arm's-length standard.

5.3.4 Documentation

The Korean TP provisions envisage two sets of transfer pricing documentation for fulfilling the disclosure requirements –

1. Primary documentation
2. Secondary documentation

The former includes the mandatory documentation to be provided by the assessee each year along with the income tax return\textsuperscript{178}. This would importantly include the declaration of the TP method used for arriving at the arm's-length price based on the

\textsuperscript{176} The National Tax Service is the tax authority in \textbf{South Korea} and is run under the Ministry of Strategy and Finance.

\textsuperscript{177} Which period may is extendable up to 5 years for assessment years on or after 1 January 2015.

\textsuperscript{178} ‘Corporate Income Tax Return’ as referred to under the Korean Acts.
summary of international transaction and Tax Returns and ancillary documentation provided.\textsuperscript{179} The LCITA requires from the Assessee –

i) TP method chosen Form;

ii) Summary of cross-border transactions; and

iii) Summary income statements\textsuperscript{180}.

Under the Primary documentation, the assessee is also required to report the following – “(i) the name of each overseas’ related party with whom the taxpayer engages in transactions; (ii) the relationship between the taxpayer and the overseas’ related party; (iii) the nature of the transaction (e.g. tangible goods, service, financing and investment); and (iv) the amount of the transaction.”\textsuperscript{181}

The monetary limit for providing the documentation under the provisions is KRW 5 billion (KRW 1 billion \{equivalent to 100 crores\} for service transactions) or amount above KRW 1 billion (KRW 200 million \{equivalent to 20 crores\} for service transactions) per transaction party, below which the requirement to submit the declaration qua the TP method is exempt.

In fact in 2015 the government in order to provide clarity and simplify the procedural aspect of documentation has issued –

a) A new “Simplified APA” for non-resident taxpayers with gross revenues less than 50 billion South Korean won (KRW) ; and

b) A mechanism for combined filing and review of unilateral Advance Pricing Agreements (APA and advanced customs valuation arrangements).\textsuperscript{182}

The latter type of documentation, i.e., secondary documentation is the one which is to be provided upon request by the NTS\textsuperscript{183}, which may include in a inter or intra-

\begin{enumerate}
\item Separate declaration forms are required in relation to the transactions involving transfers of intangible property, services, and cost-sharing arrangements. See \textit{International Transfer Pricing Report 2015/16}, PwC, 28 April 2015.
\item Both (ii) and (iii) to be provided for the foreign related parties.
\item See PwC, \textit{Transfer Pricing Report 2015/16, supra, n 387}, at p. 661; Also provide detailed statements of the cross-border intra-group transactions and summarized income statements of the foreign affiliates.
\item KPMG \textit{Global Transfer Pricing Review 2016, supra}, n. 379, p. 249.
\item The Korean Tax Authority - National Tax Service (NTS) <www.nts.go.kr>.
\end{enumerate}
company agreements, bank statements, business nuances and any other such related documents which may be requisite for the evaluation of the arm's-length price reached. The time limit for providing such documentation is 60 days starting from the date of such a request received by the assessee.

The Korean TP Regulations are yet to incorporate the OECD Country by Country Reporting (CbCR) followed by majority of the countries worldwide.

5.3.5 Advanced Pricing Arrangements (APAs)

The Republic of Korea introduced the Advanced Pricing Arrangements (APA) provisions in 1997. The provisions dealing with permissions and regulations qua these unilateral and bilateral APAs are provided under Articles 9 to 14 of the Presidential Enforcement Decree (PED).

Both unilateral and bilateral APAs are made available to the Assessee and as effective from the year 2015, the unilateral APAs may even be requested with the Advance Customs Valuation Arrangements (ACVA). Important to notice here is that there is no Limitation on the term of an APA and the assessee specifies the assessment years for which such an APA would be applicable.

The AVCA Arrangement got introduced by the Korean Customs Service (KCS) on January 1, 2015, wherein KCS can approve an importer assessee’s TP method “to determine the transaction value of goods purchased from its foreign related parties”.

As stated above, the agreements may extend to any number of years, but are usually restricted, like in India, up to 5 years. The steps for an APA are akin to the Indian Rules –

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184 Effective from January, 1997. And also exists for competent authority/MAPs available for tax treaty countries.
186 “Once approved, the ACVA will be effective for a period of three years during which the taxpayer will be protected from a customs audit.” See, Korea introduces a customs advanced pricing agreement (APA) regime, TP WEEK, INTERNATIONAL TAX REVIEW, January 03, 2008 at p. 2.
• Submit a formal application
• Number and scope of transactions falling within the ambit
• TP method to be applied
• Term Period of the APA
• Under documentation the Assessee must provide the following for the past 3 years –
  - Description of its business activities and organisation structure
  - Tax returns
  - Financial statements

As recent as an year back, the NTS simplified the APA program, especially keeping in mind the SMEs\textsuperscript{187} and referred to it as the SAPA (SME-APA). Statistically speaking, as of 2014 a total of about 270 APAs were affected out of an applied total of about 450.\textsuperscript{188} One important distinction between a Korean APA and other countries’ APA as discussed above, is that though the Korean Tax Authority, the NTS is legally bound by the terms so agreed between itself, and the Assessee, the same is not true vice-versa, i.e. the Assessee can choose not to adhere to the terms reached under the APA.\textsuperscript{189} The Assessee is also given a right to withdraw unilaterally prior to the final agreement. Importantly, all the APA requests including and especially the data and information submitted are kept confidential without the fear of being used for any TP adjustment on a later occasion and can only be used for reviewing APA requests and follow-up purposes.\textsuperscript{190}

Since the introduction of APAs into the Korean market, it is estimated that more than 250 agreements have been entered on behalf of the assessees – a figure estimated to be about 50% of the overall Korean APA market. Many of these are foreign investors wanting assurance over their tax regimes amid the auditing crackdown by Korean authorities.\textsuperscript{191}

\textsuperscript{187} Short and Medium Enterprises with annual revenue of less than KRW 50 Billion.
\textsuperscript{188} \textit{EY Worldwide Transfer Pricing Guide 2015-16}, Ernst and Young publication, 2015, at p. 304
\textsuperscript{190} \textit{ibid.}
5.4 MAURITIUS

Mauritius comes under those class of countries having zilch Transfer Pricing Regulations. It has no anti-avoidance rules, and no disclosure requirements for even thin capitalization aspects or controlled foreign companies. Countries have had to enter into special agreements and specific treaties in order to offset the effect of any base erosion due to the absence of any transfer pricing provisions in Mauritius. OMAN, KUWAIT and ZIMBABWE have entered into double taxation agreements with Mauritius. Brazil (As also Colombia) recently issued a list of countries falling within the ambit of category of tax havens in the process of facilitating compliance by the local assessees, specially in cases of non-disclosure of corporate ownership.

The Mauritian Rupee is not put to use to pay any significant corporate tax in Mauritius, where though the resident assessees are taxed on their respective worldwide income, but importantly Non-residents (NRs) are taxed only on Mauritius-source income, making it a perfect tax-haven. Other tax-haven attributes include NIL Capital Gains Tax and exempt dividends paid by a Mauritius-resident company. Furthermore zero% rate withholding tax is applicable to specified nonresidents and zero withholding tax on dividends. The Corporate tax rate in Mauritius is 15%.

Recently, India has also entered into a double taxation avoidance agreement with Mauritius to offset some of the tax haven affects whereby India would now have the

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192 Up till 2016 Mauritius has concluded more than 43 tax treaties.
194 Tax Assessment Year period runs from 1st July to 30th June.
195 Exempt from any levy of income tax.
196 An assessee company is resident in Mauritius, if it is incorporated in Mauritius and/or its central management and control is also in Mauritius.
198 “Foreign tax credit – Foreign tax paid may be credited against Mauritius tax on the same income. A company holding a Category 1 Global Business License (GBC 1 company) is entitled to claim a credit for the greater of the actual foreign tax incurred or a deemed foreign tax credit equivalent to 80% of the Mauritius tax payable, providing a maximum effective tax rate of 3%.”
199 Ibid, generally.
200 See Section 90 Of The Income-Tax Act, 1961 - Double Taxation Agreement - Agreement For Avoidable Of Double Taxation And Prevention Of Fiscal Evasion With Foreign Countries – Mauritius;
right to levy a capital gains tax on such gains arising on Indian equity shares sold by a Mauritian resident.\footnote{201}

Some of the other major amendments to the India-Mauritius DTAA also included the affirmation of the principle of source taxation whereby the income held taxable in the country in which the income arises, i.e. where the source of such income rests, plus the additional levy by India on interest\footnote{202} arising in India being paid to a Mauritius resident and levy on the FTS (fees for technical services) arising\footnote{203} in India and BEING paid to a Mauritius resident.

### 5.4.1 Transfer Pricing Regulations

Although Mauritius does not have any codified sections on transfer pricing but the Mauritius Revenue Authority (MRA)\footnote{204} implicitly upholds the Arm’s Length Principle (ALP) as provided under the Mauritius Income Tax Act 1995. Section 75 Mauritius Income Tax Act provides that in given situation, the Commissioner of Income Tax has the power to determine the income and/or profits of the assessee, where the business is controlled or carried on by non-resident (co.) and the commissioner is not satisfied of the transactions having been carried out on an arm's-length basis. This is on similar lines as provided generally under the old unamended sections 42(2) and 92 of the Indian Income Tax Act 1961, sans any specific reference to transfer pricing provisions.
Since the Mauritius Income Tax Act contains no separate specific transfer pricing regulations, the discussions regarding the transfer pricing methods, their respective priority, transfer pricing penalties and any documentation requirements, adherence to OECD Guidelines, etc., cannot be made. The frequency of any transfer pricing enquiry or relatable tax audits is at a minimum in the peculiar Mauritian milieu.

5.4.2 Documentation

That having been said, documentation will be required in case of any tax enquiry made by the Mauritius Revenue Authority, as provided above, though no specific deadline or limitation period is provided for the same.

Common to most other transfer pricing jurisdictions, the Mauritius tax law also puts the burden of proof on the assessee and requires the assessee to disclose all related party documentation and information in the financial statements in accordance with the International Accounting Standards. The assessees are recommended to maintain documents in relation to transactions, along with data on comparables and other supporting documents.

Under the Mauritian Corporate laws, seven years minimum limit is prescribed to preserve the documents, which is two years more than the five years limitation period allowed to the MRA for issuing any notice for assessment. This period got further reduced from 5 to 4 years vide amendment by the Finance (Miscellaneous Provisions) Act 2015 (FMPA 2015). The time limit of five years has been reduced to four years further to the amendment made by the Finance (Miscellaneous Provisions) Act 2015 (FMPA 2015). To date, the amendment made by the FMPA 2015 has not yet been proclaimed.

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205 To be filed annually. See Mauritius ‘Annual Finance Acts’.
206 Limitation period is four years from last filing deadline.
209 ibid, at p. 192.
5.4.3 Advanced Pricing Agreements (APAs)

In the absence of any transfer pricing provisions, there are no standards set out for any kind of advanced pricing agreements (APAs) or MAPs. The only reference akin to it is provided under Section 159 of the Mauritius Income Tax Act 1995, which can be invoked by any person seeking an advance ruling; in case such a ruling is sought under this section, the MRA is duty bound to issue the said ruling within 30 days from the receipt of the application.²¹⁰

5.5 CONCLUSION

This chapter entails the entire sanctum sanctorum of the four countries (United States, United Kingdom, South Korea and Mauritius) qua their respective transfer pricing provisions put on a comparative scale to the Indian regulations and the OECD Guidelines, highlighting respective similarities and disparities. The chapter incorporates the definition/s of the international transaction and associated enterprises along with discussing; the modus operandi in conducting the comparative analysis using the different methods provided under the regulations.

It further elucidates upon the usage of these methods and comparables to different set of transactions affecting group companies. The chapter further comprises of the jurisprudence and case laws decided by the respective local courts in the said countries providing a broad picture of the transfer pricing regime operating in the said countries.

²¹⁰ ibid, at p. 192
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<td>Presidential Enforcement Decree (PED) and Ministerial Decree and Interpretations</td>
<td>The UK’s domestic transfer pricing legislation is now consolidated and set out in Part 4 of the TIOPA 2010. This includes Sections 1.482, 1.6662, 1.6038A and 1.6038C</td>
<td>Treasury Regulations (Treas. Regs.) Revenue Procedures</td>
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<tr>
<td>Interpretation Of Arm’s Length Principle (ALP) and methods used</td>
<td>CUP, resale price, cost-plus, profit split and TNMM.</td>
<td>Not applicable</td>
<td>The South Korean transfer pricing regulations prescribe the following five transfer pricing methods: CUP, resale price, cost-plus, profit split and TNMM. Other reasonable methods can only be used if the five methods are not applicable.</td>
<td>The OECD Guidelines are followed with regard to pricing methods. All of HMRC’s guidance is based around adherence to the OECD Guidelines. Following a tax case in 2010, HMRC now more routinely challenges for tangible goods, the IRS accepts the CUP, resale price, cost-plus, CPM, profit split and unspecified methods. For intangible goods, the IRS accepts the CUT, CPM, profit split and unspecified methods. For services, the IRS accepts the services cost, comparable...</td>
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Of the aforementioned transfer pricing methods, the taxpayer is to select the most reasonable method based on the availability and reliability of data. The robustness of external CUP data (particularly in relation to IP licenses), uncontrolled services price, gross services margin, cost of services plus, CPM, profit split and unspecified methods. The regulations provide a best-method rule for determining the appropriate method to be applied by the taxpayer for each intercompany transaction.

| Pricing Methods Stringency (as per Strictness scale) | 5 | Not applicable | - | 3 | 4 |