Transfer pricing trends in Asia

with insights from the UK and EU

Webinar summary

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Introduction

Mazars at a glance

Global coverage

1

global partnership

90+

countries & territories

44,000+*

professionals

* 28,000+ professionals in Mazars' integrated partnership, 16,000 via Mazars North America Alliance

1,000+

Partners

These figures are valid as of 1 January 2022.
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Introduction
Foreword

Organisations that span international borders are increasingly facing complex tax issues. As the tax landscape continues to evolve, transfer pricing remains a top priority for multinational enterprises. The current economic landscape places transfer pricing under greater scrutiny from tax authorities around the world.

The G20 had tasked the OECD to study and deal with the issue of Base Erosion and Profit Shifting, or BEPS, by MNEs. This resulted in the OECD releasing an action plan in 2013 to target tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to locations with no/low tax rates.The BEPS initiative brings together more than 140 jurisdictions through a platform called the Inclusive Framework (IF). In October 2021, the IF agreed to a Two-Pillar solution to address the tax challenges commonly known as BEPS 2.0. Furthermore, Covid-19 has changed the economic and business environment throughout the world. Supply chain disruptions, inflationary pressures, the Ukraine war and appreciation of the US dollar against major currencies have led to many changes to the way businesses operate.

In light of this, Mazars has organised a webinar on the transfer pricing trends in Asia, with insights from the United Kingdom (UK) and European Union (EU). The webinar featured our in-house experts from Singapore, Thailand, Vietnam, Hong Kong, Indonesia, Malaysia and the UK.

Elaine Chow
Director, Tax
Mazars in Singapore

Transfer pricing trends in Asia with insights from the UK and EU

Panel of speakers

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Karen Lau
Senior Manager, Tax
Hong Kong

Cindy Susanto
Manager, Tax
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Jonathan Stuart-Smith
Partner, Tax
Thailand

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Director, Tax
Malaysia

Ben Semper
Director, Transfer pricing
The UK

Note: Kindly click on the speakers' names to learn more about each speaker.

The latest development of BEPS in the country

An overview of the local regulations in Asia, the UK and EU

Under the two-pillar solution outlined in BEPS 2.0, Pillar 1 seeks to redistribute profits and taxing rights among countries. Pillar 2, also known as the Global Anti-Base Erosion (GloBE) Rule, aims to introduce a global minimum tax.

Singapore

Under the current tax regime, Singapore's standard corporate tax rate is 17%. However, due to various tax incentives and reliefs available for certain qualifying activities, Singapore groups of companies could enjoy a lower effective tax rate.

In Budget 2022, Singapore announced that it is exploring a Minimum Effective Tax Rate (METR) on certain Multinational Enterprise (MNE) groups that will increase the group's effective tax rate in Singapore to 15%, to account for global tax developments relating to the Pillar 2. METR will apply to MNE groups operating in Singapore with consolidated annual revenues of at least €750 million or S$1 billion, as reflected in the ultimate parent entity's financial statements.

The details of how and when this rule will be implemented are being deliberated by the Government currently.

Thailand

BEPS 1.0 has been implemented in Thailand since 2019. A three-tiered TP documentation approach is in place, comprising the local file, master file and country-by-country report (CbCR). In addition, Thailand has introduced its own annual TP disclosure form.

The Thai Revenue Department is currently drafting a Pillar 2 legislation for the global minimum tax. As of now, many companies investing in Thailand benefit from incentives from the Board of Investment (BOI) and the International Business Centre (IBC), which include corporate tax exemption or reduction.

The impending global minimum tax rules will allow overseas tax authorities to tax profits derived in Thailand. At the same time, Pillar 2 includes substance-based carve-outs based on employee costs and tangible assets, which will help to cushion the impact. From a policy perspective, Thailand may also consider non-corporate tax incentives to mitigate the negative impact of the global minimum tax.

Hong Kong

In Hong Kong, BEPS 1.0 has been implemented by the introduction of transfer pricing regulations in 2018. Regarding BEPS 2.0, the government has promised that it will actively participate in the BEPS 2.0 package.

Recently, the HK government has proposed to refine the taxation regime by introducing the Foreign Source Income Exemption (FSIE) regime, which is expected to become effective on 1 January 2023, with no grandfathering arrangement.

Hong Kong is known for its simple and low tax regime. Currently, territorial source principle is in place. Offshore income and capital income are not taxable.

The proposed refined FSIE regime targets on multinational enterprises which receive four types of offshore passive income, i.e. dividend, disposal gain on shares / equity interest, interest income and income from intellectual properties (IP) in Hong Kong. Generally speaking, if a company fails to meet the economic substance requirements, the offshore dividend, disposal gain and interest received by the company will be deemed Hong Kong sourced and taxable. Nevertheless, Hong Kong would allow participation exemption for dividends and disposal gains; whilst nexus approach would be applied for IP income. Unilateral tax credit would also be allowed.

Given that the proposal would introduce new concepts and rules to Hong Kong tax law, companies are encouraged to keep an eye on its development.

The latest development of BEPS in the country

An overview of the local regulations in Asia, the UK and EU

Vietnam

Vietnam also practices a three-tiered documentation system. Detailed regulations for CbCR filing including local filing and surrogate parent filing, brings it in line with the Action 13. Interest expense deductibility is capped at 30% of earnings before interest, taxes, depreciation, and amortisation (EBITDA).

In February, Vietnam joined the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting. To facilitate tax declaration and payment, Vietnam has also released a new Digital Service Tax declaration.

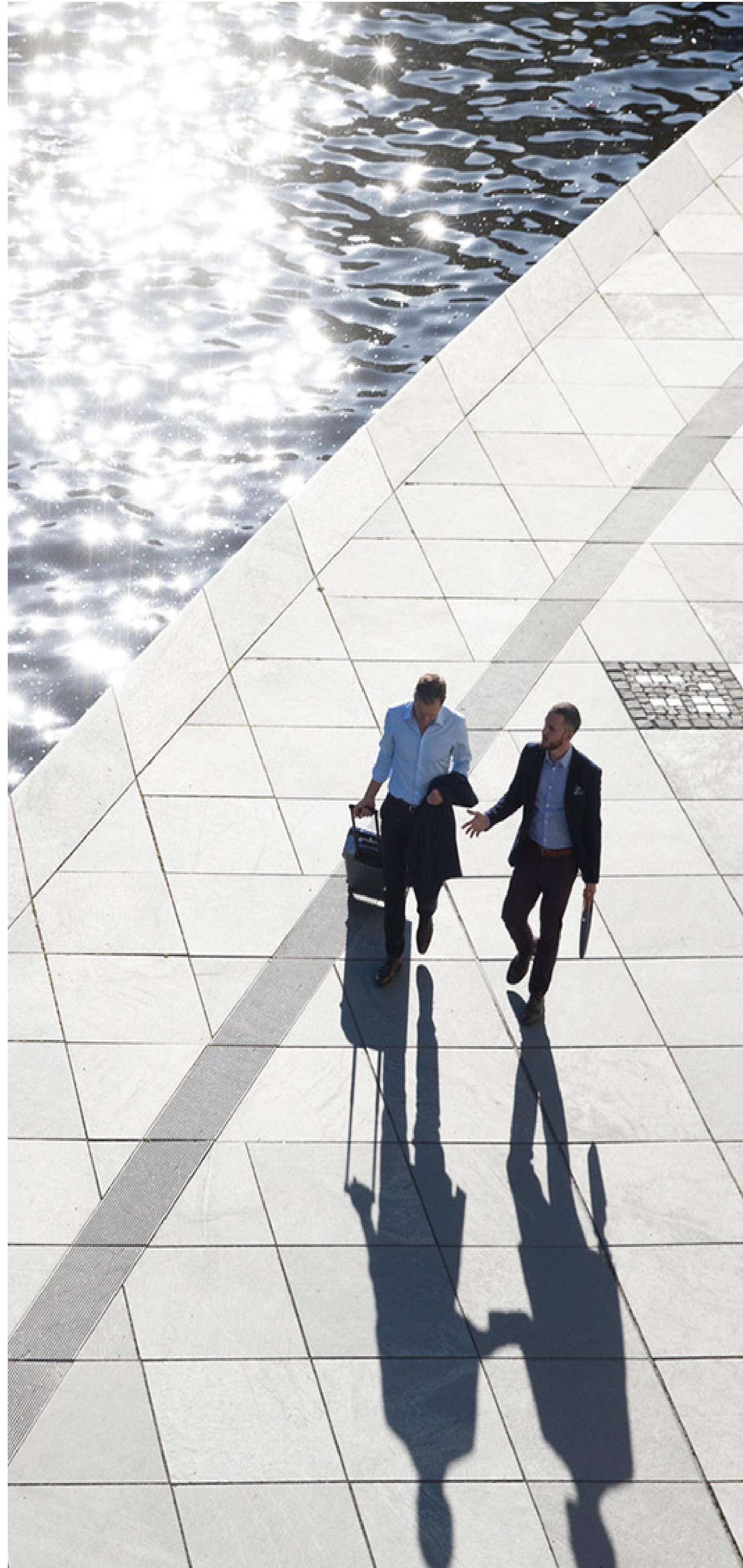
The UK and EU

The UK and EU have fully embraced BEPS 1.0 and are looking to adopt BEPS 2.0. Hungary has however been resisting the minimum tax rate which has prompted the US to give notice it will terminate its Double Tax Treaty with the country.

The EU public CbCR directive entered into force on 21 December 2021 and members states will need to transpose it into national legislation by June 2023.

Additionally, the EU is looking to introduce an Anti-Tax Avoidance Directive (ATAD) III in January 2024. The ATAD III proposal, which is set to crack down on the abusive use of shell companies, includes a tax return declaration and penalties for non-compliance.

Currently, there is no mandatory master file and local file requirement for UK taxpayers. However, beginning April 2023, the UK government will introduce a requirement for the largest MNEs to maintain a TP master file and local file in line with the OECD recommended approach.



Transfer pricing considerations

The global supply chain is experiencing sustained pressure amidst rising inflation, energy shortages, lockdowns, worker constraints and geopolitical uncertainty. As MNEs undergo operational changes, they must understand the key transfer pricing considerations in times of supply chain disruptions.

Thailand

In recent years, even before the onset of Covid-19, many MNEs have pivoted and relocated their manufacturing bases to Thailand. The BOI has identified 12 S-curve industries e.g. next generation automotive, smart electronics, aviation and logistics, automation, and robotics to target for investment. Thailand offers a number of incentives to attract investors such as a Corporate Income Tax exemption and customs duty and excise reductions, 100% foreign ownership, as well as work permit and visa facilitation.

These business changes can lead to a number of TP ramifications. For instance, when an MNE relocates its manufacturing base to Thailand, we will see a change in functions, assets and risks in both entities. With this, the MNE group is encouraged to relook at the functional analysis of their entities to understand where risks lie and assess the need for any TP policy adjustments.

Vietnam

Vietnam shows strong signs of economic recovery on the back of business reopening and resilient manufacturing. According to the World Bank, the GDP is projected to grow 7.5 percent in 2022. Similar to Thailand, Vietnam is seen as a key destination for investment.

Vietnam is party to many free trade agreements (FTAs) with large economies. The most recent agreements are the Regional Comprehensive Economic Partnership (RCEP) and the European Union Vietnam Free Trade Agreement (EVFTA). The agreements will help Vietnam's economic growth, but also give rise to a number of tax implications.

With the new Pillar 2 developments, tax incentives may not work well in the future. Vietnam is expected to conduct studies to revise its approaches in attracting foreign investment in light of the global minimum tax rate introduction. With the global supply chain changes, Vietnam will likely focus more on domestic taxes especially TP as the new standard of taxation in the country.

Transfer pricing aspects

Since the financial crash, there was a period of relative stability with regards to transfer pricing. Everything changed when Covid-19 struck. The pandemic left immense impacts on transfer pricing, with ripples in recovery afterwards. There were huge demands in supply chain, changing freight prices and rising energy costs due to the war in Ukraine. The periods of volatility and uncertainty had led to potentially complex transfer pricing issues.

While the OECD Covid-19 transfer pricing guidance remains applicable, the current environment is growing more complex. It is important to understand the overall impact on the MNE group and review the local impact on a risk basis before year end.

Some comparables will not be available just yet, but reasonable adjustments can be made from macroeconomic data. If the impact on an MNE group is more significant, and it leads to a change in decision making, the group may need to refresh the functional analysis again.

Business restructuring may occur in response to supply chain disruption or to take advantage of favourable regimes such as those in Thailand and Vietnam. Restructuring very often involves movements in assets or functions and reassignments of risk bearing.

Reallocation of assets and risks may require remuneration at arm's length, but not necessarily so. The changes in the legal form of transactions or supply chains alone may not have such a significant impact on profit allocation. As such, companies are advised to undertake their due diligence and refer to Chapter IX of the OECD guidelines when considering a reorganisation.

Transfer pricing audit trends and the management of TP disputes

Asia, the UK and EU

With the increasing focus on transfer pricing (TP), it is imperative for taxpayers to stay on top of the TP trends in order to minimise audit threats and proactively prepare for TP controversy and disputes.

Malaysia

The Mutual Agreement Procedure (MAP) is available in a tax treaty, independent of domestic recourse, through which treaty partners resolve differences regarding the treaty interpretation or application on a mutually agreed basis.

In most countries including Malaysia where tax treaties are in place, MAP is triggered when actions of one or both Contracting States result or will result in taxation not in accordance with the relevant tax convention. For instance, a taxpayer resident in Malaysia is subject to additional tax due to a TP adjustment to the price of goods or services transferred to a related party in a treaty partner country.

The taxpayer (resident in Malaysia) may request that the Malaysian Competent Authority (CA) reduce or withdraw the adjustment or that the CA of the treaty partner allow an adjustment to the income of the related party to prevent double taxation. The taxpayer's involvement is limited to presenting its views and assisting in fact-finding.

Singapore

The Inland Revenue Authority of Singapore (IRAS) stresses on good quality TP documentation and seeks to understand the commercial reasons of why the companies enter into related party transactions and the justification through form vs substance issues.

Starting from 2018, IRAS has stepped up their scrutiny of transfer pricing compliance in Singapore. IRAS increased the penalty for non-compliance from S$1,000 to S$10,000 as well as introduced its ability to make transfer pricing adjustments when related parties do not transact at arm's length and understate their profits. Once a transfer pricing adjustment is made by IRAS, this adjustment is subject to a surcharge of 5% regardless of whether there is tax payable arising from the adjustment.

The TP audit process in Singapore typically starts off with fact finding and discussion. On top of the Singapore local file, IRAS may generally request for group TP framework, intercompany agreements, and other supporting documents to ensure that the company has consistently implemented its pricing policy in accordance with the arm's length principle. Upon completion of review, IRAS may suggest how the company can improve their transfer pricing documentation, comment on whether the transfer pricing method is appropriate or whether transfer prices are at arm's length and/or make a transfer pricing adjustment and impose a 5% surcharge.

IRAS has increased scrutiny on related party transactions over recent years and depending on the response received, the case may progress through a process that includes further rounds of questioning and field audits.

"The Inland Revenue Authority of Singapore (IRAS) stresses on good quality TP documentation and seeks to understand the commercial reasons of why the companies enter into related party transactions and the justification through form vs substance issues."

Cindy Susanto
Manager, Tax
Mazars in Singapore

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Thailand

The Thai Revenue Department (TRD) uses data analytics to assess TP disclosure forms to identify high risk companies for tax audits. As part of its investigation, the department has focused on management charges and royalties. TRD has a strong preference for Thai comparables, but foreign comparables may be accepted in certain circumstances. Some companies use their Asia Pacific comparable sets for Thailand, which will likely be challenged.

Another point of note is that one-time TP adjustments are not tax-deductible. No corporate income tax deduction is applicable to expenses calculated by reference to the profits of the company, in order to prevent profit shifting.

As such, it is better for a company to track its results against its TP policy throughout the year, ideally every month or every quarter. This allows the company to make adjustments going forward for the rest of the year, if the need arises.

If the TP documentation requirements are not met, a fixed penalty of up to THB 200,000 can be imposed. Tax-geared penalties for additional tax liabilities can apply with an interest surcharge of 1.5% per month.

Hong Kong and China

In Hong Kong, the transfer pricing regulations were first introduced in 2018. There are no official announcement on the number of TP audits by the Inland Revenue Department. Based on our observation, they are usually a combination of tax and transfer pricing audit. Besides, taxpayers start using transfer pricing methodologies to negotiate with tax officers in certain cases.

China has a focus on risk management, where the tax authorities leverage "Big Data" analyses to monitor the profit level of entities and the transfer pricing risk areas. Tax authorities would request companies with risk characteristics to make a self-review and self-tax adjustments.

In general, if the tax authority is not satisfied with the self-review and self-tax adjustments made by the taxpayer, or the taxpayer seeks for a written confirmation on its tax position, an official tax investigation would be initiated. A special tax investigation can be performed on both resident and non-resident enterprises.

During the investigation, the tax authorities are empowered to request information from other relevant enterprises such as external suppliers or customers.

Indonesia

The TP audit landscape has become more aggressive in the past six years. Since 2016, the Indonesian Tax Authority (ITA) has placed an emphasis on applying the ex-ante approach on transactions with gaps against the ex-post, which has raised challenges for companies.

Following the recently launched Tax Harmonization Law (HPP Law), poor financial performance and loss over a 5-year period of operations may lead to tax adjustment using the respective industry benchmarking result. A tax audit may be triggered as a result of risk profiling conducted by the tax authority to identify transfer pricing risks, which takes into account perpetual losses, heavy related party transactions, poor economic performance with gap at more than 20% compared to the peers in a similar industry.

The preparation of transfer pricing documentation comprises local file and master file is mandatory for companies having related party transaction whose prior year's revenues exceeds IDR 50 billion (equals USD 3.7 million) p.a or; those whose prior year's revenues below the threshold however had prior year's related party transaction exceeds IDR 20 billion (equals USD 1.5 million) for transfer of tangible goods, and IDR 5 billion (equals USD 370,000) for transactions other than tangible goods; or companies having transaction with related party in jurisdiction where income tax rate is lower than that of Indonesia. Failure to comply would lead to the risk of not applying the arm's length principle implies potential tax exposure.

The TP documentation is the first level of defence in sustaining one's position. A taxpayer is encouraged to revisit the TP performance on a routine basis and understand their business and commercial drive.

Transfer pricing audit trends and the management of TP disputes
Asia, the UK and EU

Vietnam

In Vietnam, the TP audit approach is generally still at the primitive stage. In special circumstances, large companies undergo a more sophisticated TP audit.

In performing a comparability search, there is a preference for domestic comparables and internal data, whereas regional or global data may be challenged. The authorities also uses an internal government 'secret' database or an unofficial guideline from the general tax department for the profit ratio corresponding to a specific industry.

Another challenge facing companies in Vietnam is that a TP adjustment may be applied to a company's entire profit ratio, rather than only on the related party transaction.

The UK and EU

The UK

Transfer pricing disputes are usually resolved by negotiation between HMRC and the taxpayer and so UK tax cases are rather rare. The UK's Competent Authority is known for its positive approach to resolving issues related to double taxation and is very successful in the negotiation of transfer pricing disputes to avoid double taxation.

A brief overview of high profile transfer pricing cases in the EU:

- Spain vs Ikea, March 2019 Audiencia Nacional, Case No SAN 1072/2019

The tax administration issued an adjustment to the taxable profit of IKEA's subsidiary in Spain considering that taxable profit in years 2007, 2008, and 2009 had not been determined in accordance with the arm's length principle. The Spain tax authority was looking to adjust the taxpayer's results to the median in the range, but the courts held that the results need only be adjusted to the lower quartile.

- France vs Philips, September 2018, Conseil d'État, Case No 405779

The Supreme Administrative Court ruled that a deduction of government R&D subsidies from the cost base could be allowed when applying a TNMM. This judgement should be approach with caution however as in this the case the French Tax Authority failed to meet the necessary burden of proof to support their position. Positions on whether R&D tax relief can for example reduce the cost base in applying a TNMM should be supported wherever possible with comparables and economic analysis.

Trends in Italy

In Italy, all types of intercompany transactions are deeply scrutinised. For management fees and intragroup services deductibility, the IRA allows the deductions of costs only to the extent that they are connected to the taxpayer's activity, and they refer to services that have actually been rendered. This follows the OECD approach to intra-group services but with a particular focus on the specific benefits received in Italy.

For Intellectual Property (IP) related transactions, undue royalty payments exceeding the arm's length value of the licensed IP are a focus for the tax authority; for example where exploitation of brand confers limited or no value or is embedded in the product value. This can trigger a secondary adjustment related to withholding tax, under specific circumstances.

Cash pooling arrangements are also a hot topic.

How we can help

Our team consists of experienced tax specialists and transfer pricing experts with country and sector specific tax and industry knowhow .

Please engage in a conversation with our dedicated professionals at Mazars. We can assist you in providing practical advice tailored to solutions that meet your strategies and requirements.

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