

# WTS Transfer Pricing Newsletter



## Editorial

Dear Reader,

It is our pleasure to present to you the first edition of our WTS Global Transfer Pricing Newsletter for 2022.

In this latest edition of the WTS Transfer Pricing Newsletter, our colleagues from 15 countries have provided an update on recently introduced legislations and cases.

### OECD

The OECD published the new version of its OECD Guidelines, which replaces the 2017 edition. The article outlines the main changes and provides context compared to the previous version.

### Europe

Our **Austrian** colleagues explain new aspects of the Austrian TP Documentation Law regarding annual CbCR notifications.

The **Czech** contribution digs into recent case law from the Czech Supreme Administrative Court discussing the definition of related parties.

In **France**, our colleagues highlight the importance for taxpayers to have in-depth functional analyses to defend their transfer prices in the event of a tax audit, using the case of RKS in France.

In **Germany**, new case law on the determination of the arm's length interest rates of intercompany loans has been published. The German contribution discusses the three cases in more detail.

Our colleagues in **Ireland** provide an overview of local TP compliance requirements concerning Master File, Local File and CbCR.

**Italy** introduces new rules on TP documentation for MNEs that taxpayers must comply with so as to benefit from penalty protection.

**The Netherlands** have implemented legislation to end its long-standing practice of allowing unilateral downward TP adjustments. The contribution compares previous and new legislations.

The contribution from **Poland** gives a brief view on the recent changes in TP legislation including law proposals made by the Ministry of Finance.

**Portugal** has seen changes made in view of local TP regulations, resulting in a further convergence of the Portuguese TP legal framework with the rules applicable in most OECD countries.

The **UK** contribution highlights the background and the outcome of the consultation on TP documentation. Among others, the largest MNEs based in the UK are required to maintain a Master File and Local File and supporting Summary Audit Trail.

In **Ukraine**, the Ministry of Finance sets out new regulations in business purposes. The article provides further details and an algorithm of control.

#### **Rest of the world**

Taxpayers in **Brazil** may be affected by several changes in the calculation of the benchmark for interests announced by the UK's Financial Conduct Authority. The contribution from Brazil discusses this issue.

Our **Chinese** colleagues provide insights into the regulation of deducting interests charged by related parties. The arm's length principle, thin capitalisation rule and liability-asset ratio are shown in more detail.

**New Zealand's** Inland Revenue Department has introduced new BEPS disclosure requirements, which apply for both large New Zealand resident and non-New Zealand resident entities.

From 2023, the new CFC rule will be mandatory in **Taiwan**. Our colleagues present the decision of the Ministry of Finance, the background and the definition of the CFC rules under local tax law.

Yours sincerely,

WTS Global Transfer Pricing Team

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## OECD



### OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 published

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations provide guidance on the application of the "arm's length principle", which is the international consensus on the valuation of cross-border transactions between associated enterprises. They also give taxpayers clear guidance on the proper application of the arm's length principle.

The OECD published the latest version of this document on 20 January 2022. The OECD Guidelines 2022 update the 2017 edition by incorporating existing guidance issued by the OECD in recent years, as detailed in the following:

- Hard-to-Value Intangibles (now Annex II of Chapter VI): Inclusion of the "Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles - BEPS Action 8", published 21 June 2018.
- Transactional Profit Split Method (now Chapter 2 (C.1-C.5)): Inclusion of the "Revised Guidance on the Application of the Transactional Profit Split Method - BEPS Action 10", published 21 June 2018.
- Financial Transactions (now Chapter 1 (D.1.2.2) and Chapter X): Inclusion of the "Transfer Pricing Guidance on Financial Transactions: Inclusive Framework on BEPS: Actions 4, 8-10", published 11 February 2020.

As a result, the new version of the OECD Guidelines is rather a consolidation of official guidance published by the OECD pursuant to the OECD Guidelines 2017.

The publication of the new OECD Guidelines 2022 is also accompanied by timing issues: for the application by taxpayers, it is essential to use the correct version of the OECD Guidelines (or the newly added chapters). Therefore, in general, the effective date of the transaction is decisive for the selection of the guidance valid at that time.

*Prof. Dr. Axel Nientimp*  
[axel.nientimp@wts.de](mailto:axel.nientimp@wts.de)

*Melanie Appuhn-Schneider*  
[melanie.appuhn-schneider@wts.de](mailto:melanie.appuhn-schneider@wts.de)

Finally, it should be noted that while the arm's length principle has been exposed to pressure in recent years, the OECD Guidelines 2022 reiterate the arm's length principle as the international standard as defined in Article 9 of the OECD Model Tax Convention - although recognising that in some cases the application of the arm's length principle is associated with challenges (e.g. in the case of hard-to-value intangibles, etc.).

## Austria



### No annual CbCR notification required since 1 January 2022

Section 4 of the Austrian TP Documentation Law (VPDG) contains a notification obligation in connection with CbCR. The notification obligation also applies to **Austrian permanent establishments of MNE groups whose turnover exceed the threshold of EUR 750 million**. The CbCR notification must indicate which business unit is subject to the reporting obligation. The notification must generally be made for all domestic business units of an MNE group as defined by Section 3 para. 1 Austrian TP Documentation Law **annually** at the latest by the last day of the reporting FY (reporting deadline). Such a statutory deadline cannot be extended by the tax office.

Point 447 of the new Austrian Transfer Pricing Guidelines 2021, however, stipulates that for FYs with a reporting obligation that commences **after 31 December 2021**, a notification is only required if

- there have been **changes compared to the notification submitted in the previous year** (e.g. if the ultimate parent company changes).
- the **end of the affiliation to an MNE group** must be reported with an "Empty Report".

Apart from these circumstances, an annual CbCR notification is no longer required. It should be emphasised that this favourable regulation in Austria is in contradiction to the OECD Guidelines 2017 and the new OECD Guidelines 2022 (published 20 January 2022) and therefore, as a rule, deviating annual notification obligations could exist abroad. In the case of doubt, it is not objectionable to still submit an annual notification electronically via FinanzOnline in Austria.

*Mag. Martin Hummer*  
*martin.hummer@*  
*icon.at*

## Czech Republic



### The Czech Supreme Administrative Court's thoughts on related party definition

In the Czech Republic, transactions between related parties are regulated by the requirement to comply with the arm's length principle. Related parties are understood, according to § 23 para. 7 of the Czech Income Tax Act, as follows:

- a) persons related through capital (25% threshold),
- b) persons otherwise related who are persons
  1. where one person participates in the management or control of another person,
  2. where identical persons or close persons participate in the management or control of other persons, then such other persons are persons otherwise mutually related. Persons otherwise related shall not be deemed to be persons where one person is a member of the supervisory boards of two persons,
  3. controlling and controlled and also persons controlled by the same controlling person,
  4. who are close,
  5. **who have created a legal relationship predominantly for the purpose of reducing a tax base or increasing a tax loss.**

From the perspective of the precise definition of a related person, the last variant of "otherwise related persons" is the most problematic. For this reason, we consider it important to draw your attention to the judgements of the Czech Supreme Administrative Court, which are devoted to clarifying the definition.

The Czech Supreme Administrative Court is of the opinion that for the adjustment of the tax base according to § 23 para. 7 of the Czech Income Tax Act, it is essential to prove the fulfilment of the position of related persons, which is proved by the tax authority. It is true that proving a creation of a legal relationship predominantly for the purpose of reducing a tax base or increasing a tax loss is difficult, but it is not sufficient to find that the price is excessive. The only exception could be the case of a clear price overrun for goods or services

whose normal price is generally known or available, in the absence of any reasonable explanation for the acquisition of those goods or services, that it was an artificial transaction (useless for the real economic functioning of the tax entity), the only explanation for which is the reduction of the tax base. In this case, the company would also not be able to explain the difference between the price paid and the arm's length price.

Likewise, it would be sufficient evidence of creation of related persons as defined by that provision if the buyer accounts artificially increased tax costs, while the seller takes advantage of the tax loss they would already have available. **It is essential, however, that the excessive price must be quite obvious, and the circumstances of the individual case must not offer any reasonable explanation other than the performed transaction being the result of agreement of two persons to obtain a tax advantage.**

It follows from another judgment of the Czech Supreme Administrative Court (1 Afs 109/2021) that if the recipient of the service actually paid a certain price and at the same time it was not proved that the funds would be returned to them, paying for the overpriced service for the purpose of incurring higher expenses would lack any rationality as it would be financially disadvantageous.

**Both court decisions therefore result in the tax administrator's obligation to examine the possible existence of other circumstances which would indicate that such a relationship was established mainly to reduce the tax base or increase the tax loss, i.e. that the companies are otherwise related as defined by § 23 para. 7 b) of the Czech Income Tax Act.**

*Michal Kolar, Ph.D.*  
*michal.kolar@*  
*alferypartner.com*

## France



### The RKS case<sup>1</sup>: shades of nuance in TP by the French Supreme Administrative Court

TP methods are often one-sided methods according to which one party to a transaction is guaranteed a margin within a range, usually set by reference to a benchmark.

The notions of "main entrepreneur" and "routine entity" are often used, as it is the routine entity's margin which will be set, with the entrepreneur receiving the residual profit/loss. The French Tax Administration is familiar with these concepts and refers to them in its official guidelines.

In the case at hand, French company RKS was audited for years 2009 and 2010. The French Tax Administration challenged its TP policy, as it considered that the margins it achieved (-10% in 2009, -22% in 2010) were abnormally low and constituted a transfer of profits abroad. The French Tax Administration's reasoning was that RKS was not the main entrepreneur of the Group and is merely a routine manufacturer, and therefore was not supposed to suffer losses but should instead earn a margin comparable to that of similar, independent companies operated normally.

The French Tax Administration thus selected a set of eight independent French companies it considered comparable to RKS and concluded from this benchmark that RKS should have earned a margin of 2.33% in 2009 and 2.63% in 2010.

**Analysis too binary for the courts**

If the Administrative Court of Appeals followed the French Tax Administration's reasoning<sup>2</sup>, the Supreme Administrative Court overturned it, noting that the Administrative Court of Appeals:

- had merely observed that RKS was not the main entrepreneur, without further investigating its actual functional profile, and whether or not it could make sense for RKS to be in a loss-making position.
- had failed to respond to RKS's arguments, which explained that these losses were due to the realisation of a strategic risk linked to its decision to reorient its sole business towards the wind industry.

The Supreme Administrative Court therefore ruled against an overly binary reasoning, according to which a company may only be either the main entrepreneur or a routine entity, and demanded a subtler analysis allowing for more nuanced functional profiles. This approach is not inconsistent with the OECD's recommendations: its OECD Guidelines 2017, which are a reference in TP, recommend selecting the most appropriate method under the circumstances. Refusing such a binary approach also seems better in line with how diverse MNE are: if the main entrepreneur/routine entity dichotomy may be relevant for certain groups, nothing allows one to infer this would be applicable to all groups, let alone the "default" configuration for such groups. This approach is also in line with other French jurisprudences which ruled in favour of taxpayers applying other TP methods than those guaranteeing a net profit to a related party – for example, profit splits or gross margin methods.

*Valentin Lescroart*  
valentin.lescroart@  
fidal.com

*Serge Lambert*  
serge.lambert@  
fidal.com

**Practical consequences**

This judgement highlights the importance for taxpayers to have in-depth functional analyses in order to best defend their transfer prices in case of a tax audit – which is more important than ever before, as the French Tax Administration is pushing its own analyses further and further, sometimes successfully.<sup>3</sup>

**Germany****New case law on the determination of arm's length interest rates for intercompany loans**

In a series of rulings in 2019 and 2020, the German Federal Fiscal Court has abandoned its decades-long ruling practice on implicit group support and the blocking effect of para. 9 OECD Model Tax Convention. It was ruled that (i) the so-called implicit group support is not considered as an arm's length (valuable) security and (ii) the missing security of a loan is generally a condition as defined by Sec. 1 Foreign Tax Act (FTA) and not at arm's length. The BFH explained that this decision is based on the "standard banking" behaviour related to the securitisation of financial transactions. However, in its rulings of 18 May 2021 (Case No. I R 4/17 and Case No. I R 62/17) and 9 June 2021 (Case No. I R 32/17), the German Federal Fiscal Court has now relativised its case law from 2019 and 2020, provided some practical guidance on determining and reviewing interest rates for intra-group loans and remitted all the decisions to the relevant lower courts. The following presents the highlights of the respective rulings.

<sup>2</sup> CAA Versailles, 22/06/2021, n°18VE02848

<sup>3</sup> For example, see TA Montreuil, 14/01/2021, n°1812789, Sté Engie (commented in the Q3 2021 WTS Newsletter)

**Ruling of 18 May 2021 (Case No. I R 4/17)**

According to the German Federal Fiscal Court, there will often not be “the” arm’s length price, but a range of prices. In such a case, the most favourable price for the taxpayer is to be used. Contrary to the opinion of the tax office and the lower tax court, the arm’s length nature of the agreed interest rate for an IC loan must first be determined using the comparable uncontrolled price method, with differences being eliminated by adjustment calculations if necessary. This also applies to unsecured IC loans. It is only if this is not feasible that the cost plus method can be applied, pursuant to which the lender’s costs are to be determined and increased by an appropriate profit mark-up. Accordingly, the credit rating relevant for the interest rate is not the average credit rating of the entire group, but the credit rating of the borrowing group company (“stand alone” rating) under consideration of the implicit group support. Implicit group support is only to be considered if the credit rating assigned to the group company by a third-party lender exceeds the stand-alone credit rating of this company.

**Ruling of 18 May 2021 (Case No. I R 62/17)**

The German Federal Fiscal Court stated that without evidence to the contrary, it cannot generally be assumed that a third party would, acting as a prudent and conscientious business manager, use the interest rate for a secured and senior loan as a basis for determining the interest rate for a subordinated and unsecured loan. Instead, the group relation should be “ignored”: Thus, a lender would then not be an affiliated company but a third party, and its claim would not be subject to any statutory reduction in rank in the event of insolvency. The lower tax court’s reference to the statutory subordination of shareholder loans, which may not be undermined by securitisation and consequently cannot justify a risk surcharge, is therefore irrelevant. The imaginary third party would presumably only accept such a reduction in rank voluntarily in return for corresponding financial compensation. Compensation would also be at arm’s length if - as in the case in dispute - the borrower had sufficient substance to provide security for the repayment of the loan. This is because a third party would take into account not only the current financial situation, but also future economic developments when determining the terms and conditions of the loan. Thus, a third party would demand corresponding compensation due to the subordination and lack of security of the loan. If, in addition, the lower tax court finds that there is a market for subordinated loans, this market would provide the appropriate benchmark for any external price comparison. Against this background, it also does not seem far-fetched that third parties on this market are willing to grant unsecured subordinated loans against payment of a higher “price”, i.e. of an interest surcharge to compensate for a higher default risk. Consequently, such loans would also be recognised in the relationship between the company and its shareholders. Since the third parties on this market are not “traditional banks”, the usual behaviour of (comparable) third parties is decisive and not that of banks.

**Ruling of 9 June 2021 (Case No. I R 32/17)**

In the view of the German Federal Fiscal Court, the objective factual requirements of Sec. 1 FTA are met in connection with the partial write-off in the domestic market. Contrary to the plaintiff’s perspective, the income reduction as defined by Sec. 1 (1) FTA may also have occurred due to (“as a result of”) the lack of securitisation. In this respect, Article 9, para. 1 DTT USA 1989 and Article 9, para. 1 DTT France do not have a blocking effect on Section 1, para. 1 FTA.



*Prof. Dr. Axel Nientimp*  
axel.nientimp@wts.de

*Melanie Appuhn-Schneider*  
melanie.appuhn-schneider@wts.de

*Viktor Gryshko*  
viktor.gryshko@wts.de

At the same time, in the view of the German Federal Fiscal Court, the lower court had not sufficiently analysed whether the lack of securitisation was a non-“arm’s length” condition in the present case. The question regarding the arm’s length nature of the absence of a collateral for a given IC loan - and, therefore, of the arm’s length nature of a given IC loan - should be answered based on all specific circumstances of the given case (including the creditworthiness of the borrower, realistically available option related to the absence of securities, etc.). Since this had not been sufficiently analysed by the relevant lower court, the decision was remitted.

### Recommendations for action

In general, existing transfer pricing guidelines for intra-group financial transactions and existing intra-group loans (incl. loan agreements) related to German group companies should be checked and, if necessary, adjusted. The focus should also be on analysing the functional and risk profiles of the companies involved.

## Ireland



## TP Compliance requirements in Ireland

The current position in relation to Master File, Local File and CbCR requirements are as follows:

### The Master File

- Requirements/thresholds: where an Irish taxpayer forms part of MNE group and the total consolidated global revenue of the MNE group is at, or above, EUR 250 million, a Master File must be prepared and available
- Submission deadline: no later than the date on which the tax return for the chargeable period is due to be filed. The obligation to prepare a Master File annually on the corporate tax return is to be disclosed.
- Fixed penalties and tax penalties can apply in relation to any TP adjustment that ultimately arises from the incorrect implementation of TP policy.

### The Local File

- Where an Irish taxpayer forms part of a MNE group and the total consolidated global revenue of the MNE group is at, or above, EUR 50 million, a Local File is to be prepared and be available.
- **Escape clause:** for small or medium-sized enterprises (“the SME exemption”). To fall within the SME exemption, the enterprise must have:
  - › less than 250 employees; and either
  - › revenue not exceeding EUR 50 million; or
  - › total assets not exceeding EUR 43 million.
- Every Irish entity must prepare a Local File. Companies are allowed to prepare a consolidated ‘Country File’ for all Irish entities of an MNE group.
- The Country File will contain essentially the same content as a Local File. However, it must also include entity-level qualitative and financial information. Where financial information is consolidated in the country file, companies will not be treated as having complied with their TP obligations.

- Submission deadline: no later than the corporation tax filing date. The taxpayer must disclose the obligation to prepare a Master File on the corporate tax return.
- If the taxpayer is obliged to prepare documentation and fails to provide documentation within 30 days of request, the fine will be EUR 25,000 plus EUR 100 per day thereafter.

### Country by Country Reporting (CbCR)

- The CbCR according to BEPS Action 13 was implemented for FYs from 2016 onwards.
- Threshold: ultimate parent entity of the MNE group is located in Ireland and generated an annual consolidated group revenue of at least EUR 750 million in the previous year.
- Deadline for preparation and submission: within 12 months after the end of the reporting FY.
- Surrogate filing: implemented.
- Secondary filing: implemented.
- Duty of notification: yes, before the end of the FY.
- Penalties:
  - EUR 19,045 will apply for not filing or incorrectly filing the CbCR plus EUR 2,535 for every late day thereafter.
  - Ireland is a signatory of the Multilateral Competent Authority Agreement on the Exchange of CbCR.
  - OECD XML format for submission has been implemented.

### TP developments in 2022

The Finance Act 2021 (applying from 1 January 2022) provides that the OECD approach to attribution of branch profits of non-resident companies is to be implemented. Non-trading transactions (in certain circumstances) between associated periods which are both within the charge for Irish tax remain exempt from TP considerations. It further clarifies that there does not need to be consideration for the exemption to apply.

The OECD approach to branch and permanent establishments is now required. Exemptions are in place where profits are less than EUR 250,000, however in the absence of this exemption the documentary requirements regarding compliance must be strictly observed.

*Aidan García Díaz*  
[aidan.garcia@sabios.ie](mailto:aidan.garcia@sabios.ie)

## Italy



### New rules on TP documentation

As discussed in our previous Newsletter, on 23 November 2020 the Italian Revenue Agency published a new Instruction (no. 360494, the "Instruction") which materially changed the 2010 Italian Commissioner Decision on TP documentation. Starting from FY 2020, in order to benefit from the so-called "penalty protection", MNE must comply with the requirements of the Instruction that replaces the provision introduced in 2010.

On 26 November 2021, Italian Revenue Agency published Circular Letter no. 15/E (the "Circular") providing clarifications on the TP documentation rules contained in the Instruction. Below we discuss some of the main new rules in light of the above Circular.

### Structure and content of appropriate documentation

From FY 2020, the Master File is a mandatory document for all Italian taxpayers that want to access the elective Italian TP penalty protection regime (including subsidiaries of foreign groups, for which, under the previous Decision, no Master File was required in the case of non-subholding companies). The Circular confirms the possibility for the Italian taxpayer to rely on the group MF, also written in English, and specifies that in the case where the document presents a different structure or it does not provide the set of information required by the Instruction, the Italian taxpayer must integrate the MF with a structure reconciliation document and/or one or more annexes providing the missing information.

The structure and content of the TP documentation must strictly adhere to what is prescribed by the Instruction, except for partial amendments and integrations not altering the information required (in case of doubts, reference should be made to the OECD Guidelines).

The Circular confirmed that all intercompany transactions need to be disclosed and reconciled with the data to be included in the annual ITR, but the taxpayer can limit the transactions to be fully documented in the TP documentation as an option. In such cases, the penalty protection will be granted exclusively with reference to the operations described and for which the information provided is considered compliant with the Instructions.

Clarifications have been provided with reference to the term "payment" (in relation to the amount of the intercompany transactions). Under the Circular, all the transactions must be evaluated on the basis of the amount accrued for accounting purposes.

### Relevant transactions

The Circular clarifies that a transaction or a homogeneous category of transactions is considered as being not material when it does not exceed the 5% of the total amount of intercompany transactions indicated in the ITR.

However, the taxpayer must describe these transactions, even if not material, to the benefit of the penalty protection regime. In our opinion, we do not think the difference between material and not material transactions is particularly evident. It should still be specified by the Italian Revenue Agency whether a simple description will be sufficient or a complete functional and economic analysis is still required.

### Timing

The Master File and the Local File must be signed by the taxpayer's legal representative or their delegate by electronic signature with a time stamp to be appended by the date of submission of the tax declaration (recently extended to 11 months from the fiscal year-end).

The communication of the availability of the TP documentation must be made in the annual income tax return within the abovementioned ordinary deadline. The signature and time stamp can also be affixed to the TP documentation by the date of submission of a late, substitute or supplementary declaration but no later than 90 days from the ordinary deadline.

*Marina Lombardo*  
*marina.lombardo@*  
*ra-wts.it*

*Franco Pozzi*  
*franco.pozzi@sbnp.it*

## The Netherlands Netherlands disallows unilateral downward TP adjustments



### Introduction and background

Effective 1 January 2022, the Netherlands have implemented a ground-breaking legislation to end its long-standing practice of allowing unilateral downward TP adjustments.

### Previous legislation

According to previous TP legislation, where prices of the transactions between related entities differed from market conditions, a taxpayer's profit was determined as if arm's length conditions had been applied. This was the case also if this resulted in a **downward** adjustment of the profit, and even if this downward adjustment was **unilateral**, i.e. not mirrored by a corresponding adjustment at the counterparty. Based on the long-standing "informal capital doctrine", benefits arising from shareholder motives are excluded from the tax base and are requalified as capital (i.e. informal capital or deemed dividend).

### New legislation

The new rules include various measures to counter TP mismatch situations:

1. A downward adjustment is denied to the extent that no corresponding upward adjustment is included in the taxable base of the related party;
2. No step-up of the value is allowed for assets that are transferred by a related party at a value below the arm's length value to the extent that no corresponding adjustment for the arm's length value is included in the taxable base of the transferor; and
3. The amount of depreciation with respect to assets that were acquired from a related party in fiscal years starting on or after 1 July 2019 and before 1 January 2022 is limited to the amount which would be the case had the measure under 2 been in force at the time of the transfer.

### Corresponding adjustment

As is evident from the above, a key concept in the new rules is the 'corresponding adjustment', which refers to the amount that is included in the taxable base of the other party to the transaction. This may be the full amount or a part thereof, as a downward adjustment is only denied to the extent that there is no corresponding adjustment at the level of the related taxpayer.

The aim of the new legislation is not to counter a low effective taxation at the level of the related party to the transaction. Therefore, it should only be assessed if a corresponding adjustment is applied, regardless of whether the related party to the transaction is objectively exempted from corporate income tax, taxed at 0%, or the upward adjustment can be used to set-off against losses of preceding years, etc.

A difference in timing does not preclude the consideration of a corresponding upward adjustment. Therefore, the inclusion of the corresponding adjustment in the taxable base in another fiscal year does not automatically result in the denial of the downward adjustment.

The taxpayer claiming the downward adjustment has the burden of proof to demonstrate that there is a corresponding adjustment included in the taxable base of the related party to the transaction.

Frank Schwarte  
fs@atlas.tax

Eli van Exel  
eve@atlas.tax

Pauline Thio  
pt@atlas.tax

### Key takeaways

Groups with Dutch operations need to act if they:

- have previously applied unilateral downward adjustments as a result of non-arm's length intercompany transactions, or applied downward adjustments in respect of which the corresponding adjustment is not crystal clear;
- have transferred assets between group companies at non-arm's length values after 1 July 2019; or
- are a party to an APA or other tax ruling based on the informal capital doctrine, as they have lost their validity.

## Poland



### Polish regulations on "indirect" transactions with tax havens

Since 1 January 2021, new TP regulations have been in force regarding the documentation of what are called indirect transactions with residents of tax havens (Newsletter #2/2021). The regulations are to be applied by Polish taxpayers for the first time in relation to tax years beginning on or after 1 January 2021. By law, TP documentation is due by 30 September 2022 (unless Polish lawmakers enact another round of deadline extensions).

The law on the TP documentation of transactions with tax havens distinguishes between direct and indirect transactions.

Direct transactions with tax havens are sales or purchases made to or from unrelated parties based in tax havens if their value exceeds PLN 100K (ca. EUR 22K) during a tax year.

Indirect transactions with tax havens are transactions your counterparty makes with related or unrelated parties if their value exceeds PLN 500K (ca. EUR 110K) during a tax year and the beneficial owner is based in a tax haven. The beneficial owner is presumed to be based in a tax haven if your counterparty makes "settlements" during the tax year with an entity based in a tax haven. You are required to establish the circumstances of such presumption with due diligence.

#### Tax Guidance – 1st proposal

The new law on "indirect" transactions with tax havens has generated plenty of controversy among taxpayers. March 2021 saw the Finance Ministry initiate public consultations on a proposed tax guidance document explaining how to apply the tax haven presumption.

The proposal has been heavily criticised by taxpayers and tax advisors. They say that the new regulations and the proposed guidance would merely result in excessive administrative burdens. The main recommendation was to defer, suspend or even altogether withdraw the undesirable regulations. There were also a number of comments regarding the merits of the proposed guidance.

#### Tax Guidance – 2nd proposal

Following the consultations, the Finance Ministry published a new and more elaborate tax guidance proposal in December 2021. According to that proposal:

- the term beneficial owner should be understood according to the statutory definition, i.e. as the entity entitled to amounts due under the transaction;
- the disclosure duty on indirect transactions with tax havens applies only to your purchase transactions whose value exceeds PLN 500K;
- your counterparty and a tax haven resident should make a transaction of a substantial value, i.e. at least PLN 500K.

Even though the second guidance proposal makes the controversial regulations more rational in their application, it has also been criticised by taxpayers and tax advisors. In addition to urging for numerous changes to the guidance, tax advisors again recommended that the law should be repealed, temporarily suspended or at least amended.

#### Practical effect of the guidance

If the second guidance proposal is enacted without substantial changes to the published draft, taxpayers may be required to obtain beneficial owner representations from their counterparties or, in their absence, carry out a beneficial owner test.

*Maja Seliga-Kret*  
*maja.seliga@wtssaja.pl*

## Portugal



### Amendments to Transfer Pricing legislation

Ministerial Order no. 268/2021, approved on 26 November 2021, introduced relevant changes to Portuguese regulations on TP matters by revising the formerly applicable Ministerial Order no. 1446-C/2001 which had been in force for 20 years.

The new Ministerial order has been effective since its publication (27 November 2021) and, in connection with TP documentation, is applicable for tax periods beginning 1 January 2021 or after.

In general, the new legislative options reflect the international TP policy changes of the last few decades as per the revised OECD Guidelines on TP matters, as well as the EU Joint Transfer Pricing Forum, which translates into additional proximity between the Portuguese TP legal framework and the regulations in place in most of the OECD jurisdictions.

The most impactful changes approved in the new Ministerial Order that should be considered are the following:

- **Declarative obligation:** the obligation to prepare TP documentation regarding a certain tax period is now only applicable to Portuguese companies that have achieved a **total annual income of EUR 10 million** or more (as opposed to the previous limit of EUR 3 million in turnover and other profits), in the year to be reported. In any case, controlled transactions do not have to be reported if they do not exceed **EUR 100 thousand** per counterparty or **EUR 500 thousand** in total, in the respective year.
- **Documentation structure:** although the new structure was already accepted by Portuguese Tax Authorities, TP documentation is now expected to be submitted in a **dual structure composed by a Master File and a Local File**, as established in the OECD Guide-

lines. Additionally, taxpayers that are considered small or medium-sized companies may prepare a **simplified file**, in order to ease the compliance burdens of such companies.

- **TP methods:** although the admissible TP methods have remained the same, more relevance has been given to the “**other methods**” that were already mentioned in the previous legislation, with the express acceptance of asset valuation methods in connection with certain controlled transactions (i.e. real estate, shares in unlisted companies, credit rights, etc.).
- **TP adjustments:** in case the Portuguese Tax Authorities perform a TP adjustment in the context of an audit, the new legislation establishes that corrections should be aimed at the median of the arm’s length interval.
- **Specific regulations for certain situations:** the new Ministerial Order includes specific TP regulations for the correct application of the arm’s length principle with regard to transactions involving intangibles and business restructuring, that had no specific regulation under the previous legislation.

*Tiago Marreiros Moreira*  
tm@vda.pt

*Nuno Bastos*  
nb@vda.pt

*Nuno Batina*  
njb@vda.pt

Moreover, Ministerial Order no. 267/2021 was also published on 26 November 2021 and revises and updates the previous regulations applicable to the conclusion of APAs between companies and the Portuguese Tax Authorities. The new legislation updates the validity of APAs to four years, as was already established in the Portuguese CIT Code, and provides other clarifications based on the experience of the last years.

In a nutshell, we take the view that the aim of the changes introduced was to simplify the Portuguese reporting TP obligations imposed on companies and to provide greater legal certainty to the regimes under analysis.

## United Kingdom Outcome of the UK consultation on TP documentation



Following a public consultation on TP documentation, the UK government decided to introduce new legislation and require the largest MNE with presence in the UK to maintain a transfer pricing Master File, Local File and supporting Summary Audit Trail. The new requirements could take effect from April 2023.

In this article, we provide a summary on the background and the outcome of the consultation:

### Background

From 23 March to 1 June 2021, HM Revenue & Customs held a public consultation on introducing more specific transfer pricing documentation requirements in the UK. On 30 November 2021, HM Revenue & Customs published the outcome of the consultation on the government website together with HM Revenue & Customs’ response on the submissions received.

### Outcome

The UK government decided to introduce a requirement for the largest MNEs with a presence in the UK to maintain (and provide upon request) a transfer pricing Master File and Local File documentation in line with the OECD standardised approach.

The UK government also intends to introduce an additional requirement in the form of a Summary Audit Trail. The Summary Audit Trail is a short document which summarises the work undertaken by the taxpayer in arriving at the conclusions in their TP documentation.

The outcome document does not define what the term "largest" means. Based on a conversation with HMRC officials, we understand that the requirements to prepare the Master File, Local File and Summary Audit Trail shall apply to MNEs which meet the CbCR threshold. Should the rules be implemented in this form, a threshold of EUR 750 million based on consolidated group revenues would apply.

At present, the UK government does not intend to implement the additional requirements suggested in the consultation document, an International Dealings Schedule ("IDS") or a detailed evidence log, which would have increased the potential compliance burden for MNEs with a presence in the UK.

It is planned that draft legislation will be prepared in 2022 and published later this year. The new transfer pricing documentation requirements could then take effect from April 2023.

### Our assessment

Our view on the outcome of the consultation is that introducing transfer pricing documentation requirements in line with the OECD standardised approach will help MNEs to achieve greater certainty regarding the content and extent of the documentation required in the UK.

We appreciate that an IDS and detailed evidence log will not be introduced since it would have been counterintuitive to introduce additional unilateral requirements, especially when considering the great lengths that the OECD and all the contributing tax authorities, including the UK, went to in agreeing upon a format for the provision of transfer pricing information. The introduction of the Summary Audit Trail to document the steps taken in preparing transfer pricing documentation appears to be more limited and could be useful to structure and approach the preparation of transfer pricing documentation in a methodical way.

### Next steps

We now await the publication of the draft legislation to implement these new transfer pricing documentation requirements together with guidance on the content of the Summary Audit Trail.

*Ruth Steedman*  
*ruth.steedman@*  
*fticonsulting.com*

*Nicolas Boehlke*  
*nicolas.boehlke@*  
*fticonsulting.com*



## Ukraine



### Ukrainian Ministry of Finance clarifies new TP rules on business purpose

Law #466 (in force since 23 May 2020, with several further amendments) supplemented TP rules with the new provisions on business purpose.

According to this, taxpayers shall prove the business purpose of controlled transactions in TP documentation. The tax authorities received the right to disregard a transaction for taxation purposes or substitute it with an alternative one if they consider that it lacks business purpose.

The Ukrainian Tax Code specifies that transactions are deemed to lack business purpose if: (i) the principal purpose or one of the purposes of the transaction is the non-payment or underpayment of taxes or diminishing the tax profit; (ii) in comparable conditions an entity will not be prepared to buy or sell such goods, works, services or intangibles in third-party transactions.

13 January 2022 saw the Ministry of Finance approve the clarification on the application of these rules in tax control.

The Ministry confirmed that 2021 is the first reporting period to which new rules are applicable. This means that the business purpose may be audited only after 1 October 2022. It is important clarification, as in practice tax authorities wanted to see grounding of the business purpose in documentation for periods before 2021. At the same time, the Ministry noted that the new rules apply to transactions conducted in 2021 even if agreements were entered prior to that period.

The Ministry also provided guidance regarding the algorithm to be followed in determining if transactions lack business purpose.

The Ministry described indicators which may signal that a transaction lacks commercial rationality. For example, if the conditions of a transaction are not typical compared to those of the taxpayer or as seen in the market, as well as the assumption of excessive risks, etc. An important indicator is the case of taxpayer's losses when the group makes profit.

According to the Ministry, the summarised algorithm of control should be as follows:

- 1) Identification of the transaction, namely defining its substance as well as any other undocumented transactions.
- 2) Determining presence of the commercial rationality of the transaction and if such transaction could happen among independent parties. In doing that, the tax authority must check for the possible alternative arrangements with the same counterparty with similar or better economic result as well as any other realistic alternative options.

As per the result of the analysis, the tax authority then makes one of the decisions:

- Agrees that the substance of the transaction is in line with its formal arrangement and applies TP methods to check if it is at arm's length.

- Substitutes the transaction for tax purposes with one or several alternatives, should it find lack of commercial rationality and availability of realistic alternatives.
- Identifies additional undocumented transactions that prove commercial rationality and applies TP methods to check if it is at arm's length.
- Disregards the transaction for taxation purposes only if it lacks commercial rationality and there are no realistic alternatives. An example of such a case is the situation when the same economic effect may be achieved by own resources or staff of the taxpayer.

As the new business purpose control rules became operational, it is recommended for taxpayers to pay special attention to (i) available proof that the substance is in line with formal arrangement of transactions and (ii) that commercial rationality may be properly grounded.

Ivan Shynkarenko  
i.shynkarenko@wts.ua

## Brazil



### Effects of extinction of LIBOR rate to Brazilian TP controls

In 2021, the United Kingdom's Financial Conduct Authority **announced** several changes to the benchmark settings currently published by the ICE Benchmark Administration, including the cessation of the publication of EUR LIBOR settings, as well as the 1-week and 2-month USD LIBOR settings **after 31 December 2021**. The Financial Conduct Authority also decided to continue to determine and publish the 6-month USD LIBOR settings at least until the end of June 2023. These changes may have a direct impact on TP calculations performed for loans granted by and to Brazilian legal entities.

The transactions involving interest carried out by Brazilian legal entities with foreign related parties (as defined under Brazilian TP legislation), related or unrelated parties domiciled in tax havens or non-residents subject to privileged tax regimes must follow Brazilian TP rules and the thin capitalisation rules.

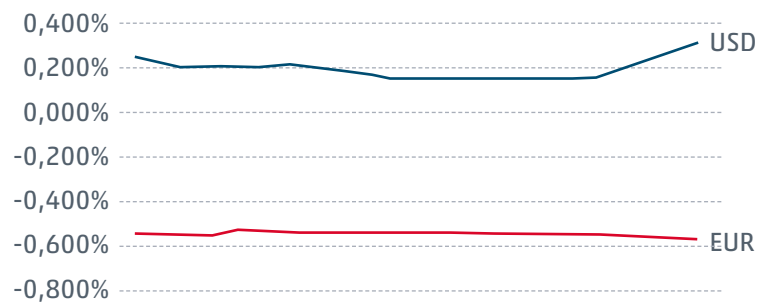
In accordance with Brazilian TP rules, the interest expenses incurred by a Brazilian legal entity shall be considered deductible up to the amount that does not exceed the rates determined based on the following rules (the minimum interest revenues recorded by Brazilian companies shall be calculated based on the same rules):

Loans in USD with fixed rates	Rate of Brazilian sovereign bonds issued in USD in foreign markets	+	<div style="border: 1px dashed red; border-radius: 50%; padding: 10px; display: inline-block;"> <p>3.5% spread p.a. (expenses)</p> <hr style="width: 50%; margin: 5px auto;"/> <p>2.5% spread p.a. (revenues)</p> </div>
Loans in BRL with fixed rates	Rate of Brazilian sovereign bonds issued in BRL in foreign markets		
Other loans	6-month LIBOR for the country of the loan; or USD LIBOR when there is no specific LIBOR rate		

As a result, after the changes announced by the Financial Conduct Authority, the Brazilian companies that used to apply EUR LIBOR to comply with the TP rules to calculate the benchmark for interest expenses (or revenues) will be forced to use the 6-month USD LIBOR ("USD LIBOR 6M").

The impact that could arise for Brazilian companies may be verified by the comparable analysis of the historical variation of EUR LIBOR 6M versus USD LIBOR 6M during 2021:

January to December 2021



Whilst the EUR LIBOR 6M was negative and relatively constant for 2021, the USD LIBOR 6M was positive and had a slight fluctuation. In view of this situation, the replacement of the EUR LIBOR 6M rate for the USD LIBOR 6M rate could result in two different scenarios: (i) if the borrower is a Brazilian company, this change could, in principle, increase the maximum amount of interest to be deducted from the Corporate Income Tax (IRPJ) and Social Contribution on Net Profit (CSLL) basis; and (ii) if the lender is a Brazilian company, this replacement could result in a corresponding increase of the minimum interest revenue to be considered by the Brazilian company for IRPJ and CSLL purposes.

The Brazilian Federal Revenue Service has not announced any changes to the rules currently in place in view of these changes.

*Stephanie Makin*  
sjm@machado  
associados.com.br

As such, Brazilian companies should evaluate whether adjustments are necessary to loan agreements currently in place, if based on EUR LIBOR settings, and verify whether additional adjustments to the loans are advisable to use other methodologies provided by TP legislation.

*Gabriel Lacerda*  
gnl@machado  
associados.com.br

It is recommended that Brazilian legal entities and multinationals with loans with Brazilian companies keep these changes in mind for future transactions.

## China



### Deduction of interest charged by related parties

Intercompany financing is common among the MNEs. For any borrowing from related parties, the Chinese borrowers must pay interest to them. In China, the deductibility of interest expenses charged by related parties is subject to special tax requirements.

Firstly, the arm's length principle should be followed. According to the Chinese CIT Law, for a borrowing from a non-financial company, the part of interest expense exceeding the interest rate for the same type of loans of a financial company (i.e. commercial banks, financial companies, trust companies and other financial institutions) shall not be deducted for CIT purposes. Practically, the Chinese tax authorities would refer to the interest rates published by the People's Bank of China and prefer the interest rates being set between the

deposit interest rate and the loan interest rate of commercial banks. If the interest rate of the IC loan is higher than the said rate of commercial banks, the Chinese company may still enjoy the expense deduction by providing the rationality of that interest rate. Otherwise, it will be difficult for them to claim the expense deduction for the interest charges by related parties.

Secondly, the thin capitalisation rules should be complied with. The Chinese tax authorities could monitor whether or not the ratio of debt-to-equity investment that an enterprise receives from its related parties (associated liability-asset ratio) exceeds the standard ratio;

- for a financial enterprise, 5:1; or
- for any other enterprise, 2:1.

When an associated liability-asset ratio has exceeded the standard ratio, the interest expense exceeding the ratio (interest actually paid to all related parties \* (1- standard ratio/ associated liability-asset ratio)) will not be deductible for CIT purposes. However, the interest expenses actually paid may still be permitted for deduction, if the company is able to:

- 1) prove that the interests are actually paid to a domestic related party facing a higher tax rate; or
- 2) provide a special TP file to prove that the amount, the interest rate, the term, and financing conditions of its associated debt investments as well as its liability-assets ratio, among others, has complied with the arm's length principle. The special TP file should include:
  - Analysis of the solvency and borrowing capacity of the company;
  - Analysis of the borrowing capacity and financing structure of the group;
  - Explanation on changes in equity investments such as the registered capital, etc;
  - Nature and objective of debt investments of related parties and the market conditions when the debt investments were made;
  - Currency, amount, interest rate, term and financing terms of debt investments of related parties;
  - Collaterals provided and terms and conditions thereof;
  - Status of guarantor and terms and conditions for guarantee;
  - Interest rates and financing terms for the same type of loans in the same period;
  - Terms and conditions for the conversion of convertible corporate bonds; and
  - Any other materials which can prove that the arm's length principle is complied with.

Thus, for claiming a deduction for interest paid to related parties, it is crucial for companies to review in advance whether or not the interest rate of an IC loan is appropriate, and whether a special TP file can support the interest expense deduction.

## New Zealand



### New BEPS disclosure guidance and preparation forms

The Taxation (Neutralising Base Erosion and Profit Shifting) Act 2018 made a series of changes to New Zealand's international tax rules, as a domestic law response to the OECD/G20's BEPS project.

To support the new rules, including the expanded information collection powers applying to large MNEs, New Zealand's Inland Revenue has introduced a BEPS disclosure form, IR1250, together with a guidance form to assist with completion, and an extensive table intended to provide help for taxpayers to determine their hybrid compliance and disclosure obligations. The most recent set of forms is now available.

These disclosures are independent of the amendments to New Zealand's TP legislation which took place with application for income years beginning on or after 1 July 2018.

Because New Zealand operates a self-assessment regime for taxpayers, it is important to understand whether the BEPS disclosure requirements apply and, if so, to complete them accurately and in a timely manner. It should be noted that the disclosure requirements apply to both large New Zealand resident and non-New Zealand resident entities.

There are three distinct parts to the BEPS disclosure:

- Hybrid and Branch Mismatches;
- Thin Capitalisation Group Information; and
- Restricted TP Rules.

Each part requires careful and detailed completion (to the extent relevant) by or on behalf of the taxpayer and is required to be submitted via the "myIR" electronic portal. For example, the hybrid and branch mismatch section could require:

- Hybrid entity/branch/dual resident disclosure
- Hybrid payment disclosure
- Hybrid receipt disclosure
- Double deduction disclosure
- Imported mismatch disclosure.

In the context of the restricted TP rules applicable to related-party loans of NZD10 million or more (and the consequences in terms of the deductibility of interest), a careful consideration of the restricted credit rating, group credit rating, optional credit rating insuring or lending person and loan features that may be disregarded is required, as set out in sections GC 16 – GC 18 of the Income Tax Act 2007. The answers can of course also result in an adjustment affecting the tax position of a group in one or more other jurisdictions too.

The BEPS disclosures relate to legislation which is technically complex and highly dependent on the facts and circumstances of taxpayers and the arrangements to which they are party. Many taxpayers will have undertaken work in their home jurisdictions to assess the

impact of the BEPS changes, and we recommend that consideration be given to obtaining New Zealand assistance to complete the BEPS disclosures in an accurate and complete manner, and to understand the consequences. BEPS disclosures should always be considered well before completion of a taxpayer's New Zealand and other income tax returns.

*Neil Russ*  
*neil.russ@russ*  
*associateslaw.com*

The forms, and a series of special reports by officials in relation to specific aspects of the BEPS rules (relating to interest limitation, hybrids, TP, permanent establishments and administrative measures) can be accessed from:

[www.ird.govt.nz/international-tax/business/beps-disclosure](http://www.ird.govt.nz/international-tax/business/beps-disclosure)

## Taiwan



### Taiwan CFC rules will be implemented as of 2023 in response to the Global Minimum Tax

On 14 January 2022, Taiwan's Executive Yuan announced that controlled foreign company (CFC) rules will come into force in 2023 in response to Pillar Two of the OECD's Global Anti-Base Erosion (GloBE) Proposal. Taiwan's CFC rules aim to prevent the artificial diversion of profits from Taiwan to CFCs operating in low- or zero-tax jurisdictions. They were introduced in 2016 for corporations<sup>4</sup> and in 2017 for individuals<sup>5</sup> but have since been pending an implementation date from the Executive Yuan.

When the Management, Utilisation, and Taxation of Repatriated Offshore Funds Act was enacted in July 2019, an accompanying resolution was made requiring the Taiwanese Ministry of Finance to report to the Executive Yuan for approval of an implementation date within one year after the expiration of a date set in the Management, Utilisation, and Taxation of Repatriated Offshore Funds Act, which fell on 16 August 2021. The CFC rules were estimated to take effect in 2022 at the earliest. Now, so as to align with the OECD's timeline for domestic implementation of a 15% global minimum tax (which takes effect in 2023), Taiwan's government has decided that its CFC rules will be implemented on 1 January 2023.

#### Definition of a CFC under Taiwan law

A foreign entity is deemed a CFC if:

- (1) it is resident in a low-tax country or jurisdiction, defined as one having a corporate income tax rate not exceeding 70% of Taiwan's current tax rate (70% of 20% is 14%), or which taxes only domestically sourced income (or foreign-sourced income is taxed only on a remittance basis); and
- (2) 50% or more of the entity's shares are directly or indirectly owned by, or are substantially influenced by, a Taiwanese enterprise or individual or persons related to a Taiwanese enterprise or individual.

#### CFC exemptions and threshold requirements

The CFC rules would not apply where:

- (1) the CFC carries on substantive economic activities in a low-tax country or jurisdiction and its passive income (such as rent, interest income, royalties, and dividends) does not exceed 10% of the CFC's total income (income from overseas branches is excluded); or

<sup>4</sup> Article 43-1 of the Income Tax Act.

<sup>5</sup> Article 12-1 of the Income Basic Act.

- (2) the annual revenue of the CFC does not exceed TWD 7 million.<sup>6</sup>  
After the implementation of the CFC rules, a Taiwan corporate taxpayer may be subject to corporate income tax on its share of the CFC's undistributed income unless CFC exemptions are met. The same also applies to an individual shareholder. For any individual who directly holds 10% or more of shares or capital of a CFC, calculated together with the shares owned by his/her spouse and second-degree relatives, the income earned by the CFC would be deemed distributed to the Taiwanese shareholder in proportion to his/her shares. The deemed dividends would be further regarded as the individual's overseas income and may be subject to a 20% alternative minimum tax rate.

**CFC and Taiwan's version of GloBE**

*Holly Chu*  
*holly.chu@eiger.law*

*Joanne Lee*  
*joanne.lee@eiger.law*

To catch up with global trends and enhance Taiwan's competitive edge in the international tax community, Taiwan decided to implement its CFC rules in 2023, with the aim of ensuring the effective tax rate of CFCs meets the global tax standards. It is advisable for businesses or shareholders to re-examine their organisational structure and analyse potential tax risks under the CFC rules.

**Glossary**

<b>APA</b>	Advance Pricing Agreement	<b>GMT</b>	Global Minimum Tax
<b>BEPS</b>	Base Erosion and Profit Shifting	<b>IC</b>	Intercompany
<b>CbCR</b>	Country-by-Country Reporting	<b>IDS</b>	International Dealings Schedule
<b>CFC</b>	Controlled Foreign Company	<b>LIBOR</b>	London Interbank Offered Rate
<b>CIT</b>	Corporate Income Tax	<b>MNE</b>	Multinational Enterprise
<b>DTT</b>	Double Taxation Treaty	<b>OECD</b>	Organization of Economic Cooperation and Development
<b>EU</b>	European Union	<b>OECD Guide-lines</b>	OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
<b>FTA</b>	German Foreign Tax Act (AStG)	<b>SME</b>	Small or Medium-Sized Enterprises
<b>FY</b>	Fiscal Year	<b>TP</b>	Transfer Pricing
<b>GLOBE</b>	Global Anti-Base Erosion		

<sup>6</sup> However, if all the CFCs controlled by a Taiwanese company have a positive balance and the total annual earnings exceed TWD 7 million, in this case they would still be recognised as investment income of said Taiwanese company. In other words, the CFC rules will be applied.

## Contact/Editors

### OECD

**Prof. Dr. Axel Nientimp**

axel.nientimp@wts.de

T +49 211 20050 714

**Melanie Appuhn-Schneider**

melanie.appuhn-schneider@wts.de

T+49 211 20050 645

**WTS Steuerberatungsgesellschaft mbH**

Klaus-Bungert-Str. 7

40468 Düsseldorf

www.wts.com/de

### Austria

**Mag. Martin Hummer**

martin.hummer@icon.at

T +43 732 69412-9894

**ICON Wirtschaftstreuhand GmbH**

Stahlstraße 14

4020 Linz

www.icon.at

### Czech Republic

**Michal Kolar, Ph.D.**

michal.kolar@alferypartner.com

T +420 221 111 777

**WTS Alfery s.r.o.**

Vaclavske nam. 40

110 00 Prague 1

alferypartner.com

### France

**Valentin Lescroart**

valentin.lescroart@fidal.com

**Serge Lambert**

serge.lambert@fidal.com

T + 33 1 55 68 14 44

**FIDAL**

4-6 Avenue d'Alsace

92982, Paris la Défense cedex

www.fidal.com/en

### Germany

**Prof. Dr. Axel Nientimp**

axel.nientimp@wts.de

T +49 211 20050 714

**Melanie Appuhn-Schneider**

melanie.appuhn-schneider@wts.de

T+49 211 20050 645

**Viktor Gryshko**

viktor.gryshko@wts.de

T +49 211 20050 650

**WTS Steuerberatungsgesellschaft mbH**

Klaus-Bungert-Str. 7

40468 Düsseldorf

www.wts.com/de

### Ireland

**Aidan García Díaz**

aidan.garcia@sabios.ie

T +353 1 598 0800

**Sabios**

4 Waterloo Road

Ballsbridge, Dublin 4

www.sabios.ie

### Italy

**Marina Lombardo**

marina.lombardo@ra-wts.it

T 02 36 75 11 45

**WTS R&A Studio Tributario**

Corso Europa, 2

20122 Milan

www.ra-wts.it

**Franco Pozzi**

franco.pozzi@sbnp.it

T 02 02 763693 1

**Studio Biscozzi Nobili Piazza**

Corso Europa, 2

20122 Milan

www.sbnp.it



## Contact/Editors

### The Netherlands

**Frank Schwarte**

fs@atlas.tax

T +31 6 3168 8622

**Eli van Exel**

eve@atlas.tax

T +31 6 1533 1923

**Pauline Thio**

pt@atlas.tax

T +31 6 1954 3280

**Atlas Fiscalisten**

Weteringschans 24

1017 SG

www.atlas.tax/en

### Poland

**Maja Seliga-Kret**

maja.seliga@wtssaja.pl

T +48 661 770 703

**Doradztwo Podatkowe WTS&SAJA Sp. z o.o.**

Roosevelta 22

60-829 Poznań

www.wtssaja.pl

### Portugal

**Tiago Marreiros Moreira**

tm@vda.pt

**Nuno Bastos**

nb@vda.pt

**Nuno Batina**

njb@vda.pt

T +351 21 311 3485

**Vieira de Almeida & Associados –**

**Sociedade de Advogados, SP, RL.**

Rua Dom Luís I, n.º 28

1200-151, Lisboa

www.vda.pt

### United Kingdom

**Ruth Steedman**

ruth.steedman@fticonsulting.com

T +44 (0) 2037271711

M +44 (0) 7583096126

**Nicolas Boehlke**

nicolas.boehlke@fticonsulting.com

T +44 (0) 2072699346

M +44 (0) 7583086365

**FTI Consulting LLP**

200 Aldersgate

Aldersgate Street

London EC1A 4HD

www.fticonsulting.com

### Ukraine<sup>1</sup>

**Ivan Shynkarenko**

i.shynkarenko@wts.ua

T +38 044 490 71 97

**WTS Consulting/KM Partners**

5th floor, 5 Pankivska St.

01033, Kyiv

http://wts.ua/en

### Brazil

**Stephanie Makin**

sjm@machadoassociados.com.br

T +55 11 3093-4834

**Gabriel Lacerda**

gnl@machadoassociados.com.br

T +55 11 3093-4686

**Machado Associados**

Av. Brig. Faria Lima, 1656 – 11th floor

São Paulo

www.machadoassociados.com.br/en

### China

**Maggie Han**

maggie.han@wts.cn

T +86 21 5047 8665

**WTS China Co., Ltd.**

Unit 06-07, 9th Floor, Tower A

Financial Street Hailun Center

No.440 Hailun Road, Hongkou District

200120, Shanghai

www.wts.cn

<sup>1</sup> The office of WTS Consulting Ukraine/KM Partners in Kiev is currently unavailable. Until our colleagues in Ukraine are able to restore work remotely, please do not hesitate to address your tax-related queries in relation to Ukraine to our colleague Dr. Igor Fleischmann at the Düsseldorf office of WTS Germany by e-mail at: igor.fleischmann@wts.de

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WTS Transfer Pricing

Newsletter

## Contact/Editors

### New Zealand

**Neil Russ**

neil.russ@russassociateslaw.com

T +6421349668

**Russ + Associates**

PO Box 481

Shortland Street 1140

Level15, 36 Kitchener Street

Auckland 1010

www.russassociateslaw.com

### Taiwan

**Holly Chu**

holly.chu@eiger.law

**Joanne Lee**

joanne.lee@eiger.law

T +886 2 2771 0086

**WTS Consulting (Taiwan) Limited/**

**Eiger Law**

2F., No. 25-2, Sec. 4

Ren'ai Rd., Da'an Dist.

106, Taipei City

<https://eiger.law>

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### Imprint

WTS Global  
P.O. Box 19201 | 3001 BE Rotterdam  
Netherlands  
T +31 (10) 217 91 71 | F +31 (10) 217 91 70  
[wts.com](https://www.wts.com) | [info@wts.de](mailto:info@wts.de)

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