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Amendments to the transfer pricing legislation

We provide you with a comprehensive overview of the most significant changes applicable as of 1 January 2016 that affect transfer pricing rules. As of now, not all changes are clarified and further guidance through norms or update of secondary legislation is expected in near future.

Cancellation of interest and late payment penalties

Taxpayers will be able to benefit from the cancellation of late payment penalties and from 54.2% reduction in related interest payments, if, among others, they settle the outstanding principal obligations due as of 30 September 2015 by 31 March 2016.

Union Customs Code – new provisions on the suspensive customs procedures

The Union Customs Code, which will enter into force on 1 May 2016, will bring significant changes to customs procedures with an economic impact.

Under the new provisions, the condition to re-export goods after the inward processing procedure will no longer be mandatory. In this regard, the inward processing suspension procedure will merge with processing under customs control regime and the drawback procedure will be abandoned.

Thus, for goods intended to be released into free circulation in the Community, the related customs debt can be determined both on the basis of the taxation elements related to the processed products as well as on those of goods initially placed under inward processing - i.e. raw materials.

In specific cases, for example when goods placed under the inward processing procedure are subject to commercial measures (e.g. anti-dumping duty, anti-subsidy measures, etc.), the customs duties can only be determined based on the taxation elements related to the goods initially placed under the inward processing procedure.

What does it mean for you?

The Union Customs Code, implicitly the new provisions on inward processing procedure, can have a significant impact on your company's customs activities.

What to do?

If your company currently holds an authorization for inward processing or processing under customs control, your customs activities will have to be reviewed and particular attention will need to be paid to the procedure's new provisions and to the method of customs duties calculation considering the new rules.

If you have questions or you want more details regarding the inward processing procedure and how to apply for it, please do not hesitate to contact us.

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BEPS Final Report Updates on Profit Split

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As part of the 2015 deliverables, the OECD Secretariat issued a short summary of the status of the ongoing work on the use of profit splits, in advance of additional guidance to be included in the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

Further work on profit splits will be undertaken during 2016 and into 2017. A discussion draft on profit splits will be released for public comments in advance of a public consultation to be held in May 2016; the guidance is expected to be finalized by June 30, 2017.

In the summary, which describes the scope of work for guidance on the transactional profit split method, the OECD Secretariat recognized that any guidance on profit splits should take into account the rise of integrated models common in the digital economy and the additional guidance provided on (i) the allocation of risk, (ii) group synergies, (iii) the valuation of transactions involving intangibles, and (iv) the splitting of the return on intangibles as a result of the risks incurred and functions performed by different entities within the multinational enterprise.

Use of the Transactional Profit Split Method

In December 2014, the OECD Secretariat released a discussion draft on the use of the profit split method for transfer pricing in the context of global value chains. This was in response to the objective in the BEPS Action Plan that transfer pricing rules should be improved to "put more emphasis on value creation in highly integrated groups," and the observation that use of the profit split method may be one means of achieving this.

The OECD has now outlined the themes that emerged from the responses to the discussion draft, and scoped the further work to be done to clarify, improve, and strengthen the guidance on (i) when it is appropriate to apply a transactional profit split method and (ii) how to apply the transactional profit split method in a reliable way. Importantly, the summary now recognizes that the profit split method "may not be straightforward for taxpayers to apply, and… tax administrations to evaluate." It notes that it may be the most appropriate method to align profits with value creation in accordance with the arm's length principle, particularly when the facts of the case make other transfer pricing methods problematic.

The scope of work document states that the revised guidance will be based on existing guidance, but will clarify and supplement it, with practical application illustrated through examples. In selecting the most appropriate method, attention should be given to the consequences of greater integration of business models as a result of the digitized economy, and the potential role of profit splits to account for such integration. In addition, the work will develop approaches to transfer pricing in situations in which the availability of comparables is limited.

Selection of the 'Most Appropriate' Method

The approach to applying the arm's length principle continues to require the selection of the most appropriate transfer pricing method. The sharing of profits or losses under a profit split reflects a fundamentally different commercial relationship between the parties, in particular concerning risk allocation, to the payment of a fee for goods and services. When a sharing of profits would be unlikely to represent an arm's length outcome, the revised guidance will emphasize the need to use and adjust the best available comparables rather than a profit split method. This will be more reliable than an inappropriate use of the profit split method.

Highly Integrated Business Operations

The work will consider when significant integration of business operations may lead to a transactional profit split being the most appropriate method. It will include guidance on the relevance of a value chain analysis. It may be helpful to distinguish between sequential integration of a global value chain (which may involve group companies performing different activities linked through transactions between them in a coherent value chain, and which may not warrant the use of a profit split) and parallel integration, which may involve group companies performing similar activities relating to the same revenues, costs, assets, or risks within the value chain.

Unique and Valuable Contributions

Additional guidance and examples will be provided to clarify what constitutes "unique and valuable" contributions (other than in relation to intangibles) in considering when a transactional profit split

method might be the most appropriate. Guidance will also be provided on when a transactional profit split should be selected as the most appropriate method in cases involving the performance of important functions relating to the development, enhancement, maintenance, protection or exploitation of intangibles. The guidance will include references to third-party situations in which profit split models are used.

Synergistic Benefits

Additional guidance will be provided on dealing with scenarios with significant group synergies and, if appropriate, how profit split methods could be applied to them.

Profit Splitting Factors

The guidance will focus on the need for a strong correlation between profit allocation factors and the creation of value to ensure an outcome that is consistent with the arm's length principle. The sensitivities and practical application of various mechanisms for allocation, including the capability to independently verify underlying data, will be included.

Use of Profit Split to Determine an Arm's Length Range

Guidance will be provided on evaluating whether a transactional profit split method can be used to support results under a transactional net margin method, or to determine royalty rates.

The impact of new provisions on businesses

Additional guidance on the use of the profit split method, including practical commercial examples, will be helpful for both businesses and tax authorities. The challenge for the OECD Secretariat will be to provide clear principles to be taken into account consistent with the arm's length standard, and to provide practical guidance that both business and tax administrators can apply without resort to protracted discussions and controversy, particularly given that it will not be possible to provide examples for every situation that may arise given the inherent variety in commercial value chains. Even with additional guidance, uncertainties may remain around the practical difficulties of applying the profit split method in situations involving potentially multiple jurisdictions and ensuring that tax authorities in multiple countries are able to come to a principles-based agreement based on the arm's length standard.

For further questions regarding the aspects mentioned in this alert, please contact us.

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Amendments to the transfer pricing legislation

Amendments to the Fiscal Code

Title I – General provisions

Chapter 3. Definitions

Art. 7 Definition of the common terms

Paragraph (21), c) which defines the affiliation relationship between two legal persons is amended and becomes paragraph (26), as follows:

c) a legal person is affiliated with another legal person if at least this person owns, directly or indirectly, including holdings of affiliated persons, a minimum of 25% of the value/number of the participation titles or voting rights of the other legal person or if effectively controls the legal person;

~~(ii) the second legal person owns, directly or indirectly, including holdings of affiliated persons, a minimum of 25% of the value/number of the participation titles or voting rights of the first legal person;~~

~~(iii) a third legal person owns, directly or indirectly, including holdings of affiliated persons, a minimum of 25% of the value/number of the participation titles or voting rights of both the first and the second legal person.~~

d) a legal person is affiliated with another legal person if a person owns, directly or indirectly, including holdings of affiliated persons, a minimum of 25% of the value/number of the participation titles or voting rights of the other legal person or if effectively controls that legal person.

Further, the arm's length principle definition is included, stating that when "conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly".

Chapter 4. Rules of general application

Art. 11. Special provisions for application of Fiscal Code

The provision stating that the fiscal authorities may estimate the amount of income or expense of either related party based on the level of the central market trend, if the taxpayer does not provide the competent tax authority with the necessary data to establish whether the transfer prices are in accordance with the arm's length principle is introduced.

The provision stating that the Fiscal Procedure Code is used to establish the adjustment / estimation procedure, to set the level of the central market trend and to establish the cases when a taxpayer has not provided the necessary data to establish whether the transactions are compliant with the arm's length principle is introduced.

The transfer pricing methods used to establish the arm's length value of the transactions carried out between related parties are amended by including the transactional net margin method and profit split method.

It is now specified that the provisions of the Transfer Pricing Guidelines for Multinational Enterprises and Fiscal Administrations issued by the Organization for Economic Cooperation and Development are to be considered for the application of the provisions for the establishment of a consistent approach to the arm's length principle within the adjustment / estimation procedure.

Title II – Corporate income tax

Chapter 3. International fiscal aspects

Clarifications of the provisions regarding permanent establishments' revenues are made. As such, starting 1 January 2016 it is indicated the method of establishing the fiscal result (comprising either taxable profit or loss) and not only the taxable profit, as previously stipulated.

Amendments to the Fiscal Procedure Code

Title III. General procedural provisions

Chapter 2. Documents issued by tax authorities
(Chapter 4 as of 1 January 2016)

Art. 42 Binding ruling (BR) and the advance pricing agreement (APA)
(Art. 52 as of 1 January 2016)

Within paragraph (2) the provision that the possibility of requesting an Advance Pricing Agreement (APA) also extends to permanent establishments is introduced.

Paragraph (3) is amended and becomes paragraph (10), according to which BR or APA is communicated not only to the intended taxpayer, but also to the competent tax authority for administering the tax receivables due by the taxpayer.

Paragraph (6) is amended and becomes paragraph (9), by which if the taxpayer does not agree with the issued APA, there is an extended term of 30 days compared with the previous term of 15 days to notify the issuing tax authority.

Paragraph (12) is amended and becomes paragraph (22), which now specifies that the procedure for issuing a BR or an APA as well as the content of the application form for issuing the BR or APA and the application for amendment, extension or revision of the APA is determined now by order of president of the National Agency of Fiscal Administration ("ANAF"), and not by Government decision.

Paragraph (14) which provides the possibility of extending an APA is included. This can occur in situations when the taxpayer requests the inclusion of other transactions concluded with related parties within the APA.

Fees for issuing an APA and BR are included within paragraphs (16) and (17), as follows:

- For APA:
    - EUR 20,000, for large taxpayers, respectively EUR 15,000 in case of amendments;
    - EUR 10,000 for other categories of taxpayers, respectively EUR 6,000 in case of amendments;
- For BR:
    - EUR 5,000 for large taxpayers;
    - EUR 3,000 for other categories of taxpayers.

The steps for obtaining an APA are settled as follows:

- Preliminary discussion with the competent tax authority, requested by the taxpayer;
- Application form documentation BR / APA;
- Presentation of the administrative document project by the competent tax authority;
- Deadline for submission by the taxpayer of any opinion or any required completions.

Title IV. Fiscal registration and accounting and tax records

Art. 79 Obligation over tax records

(Starting 1 January 2016, found under Title V. Establishing tax receivables, Chapter 5. Accounting and fiscal records, Art. 108)

Paragraph (2) regarding the preparation and submission of the transfer pricing file is amended. The amendment provides that the taxpayer who carries out transactions with related parties is required to prepare the transfer pricing documentation and at the request of the competent central tax authority the taxpayer / payer is obliged to present the transfer pricing documentation.

Two other elements which require approval by order of the president of the ANAF, respectively the amount of transactions for which the taxpayer / payer is obliged to prepare a transfer pricing file and related deadlines for its preparation are introduced. However, the order was not issued up to date.

Title VI^1. Mutual agreement procedure to avoid / eliminate double taxation

(Title IX as of 1 January 2016)

Art. 93^2 The procedure for eliminating double taxation between Romanian affiliates
(Art. 283 as of 1 January 2016)

Paragraph (3) is amended and starting 1 January 2016, the adjustment / estimation shall be decided by the competent tax authority through the issuance of the tax decision for the controlled taxpayer "after the final settlement of the tax decision in the system of administrative and judicial appeals", and not by issuing an adjustment decision that underpins a tax decision / decision of not amending the tax base, as previously stipulated.

Paragraph (4) is amended, according to which, starting 1 January 2016, the adjustment / estimation decision is enforceable against the tax authority responsible with monitoring the fiscal position of the Romanian affiliate only if another / other affiliated party(ies) already performed related adjustments in order to avoid double taxation and not if the adjustment decision is final settled in the system of administrative and judicial appeals, as it was provided before.

If you have questions or you want more details regarding the inward processing procedure and how to apply for it, please do not hesitate to contact us.

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Cancellation of interest and late payment penalties

Taxpayers will be able to benefit from the cancellation of late payment penalties and from 54.2% reduction in related interest payments, if, among others, they settle the outstanding principal obligations due as of 30 September 2015 by 31 March 2016.

According to Emergency Ordinance no 44 / 2015, in certain conditions part of the interest (54.2%) and late payment penalties relating to state budget payment obligations due on 30 September 2015 could be cancelled.

The following payment obligations are not considered residual:

- obligations for which payment incentives were granted and are ongoing, as on 30 September 2015;
- obligations set forth in administrative acts whose execution has been suspended;
- individualized obligations in enforcement orders issued according to the law and submitted to the tax department responsible for collection;

We present below some conditions required to apply for the cancelation of late payment penalties and interest (54.2%):

- Outstanding principal obligations must be settled by 31 March 2016;
- 45.8% of related interest must be settled by 30 June 2016;
- Principal payment obligations administered by NAFA with payment terms ranging between 1 October 2015 and 31 March 2016 must be settled before the Application for cancelling the accessories obligations (penalties and a share of 54.2% of the interest) is submitted;
- The application for cancelling the accessories obligations should be submitted by 30 June 2016.

Under similar conditions, other types of accessories obligations could be cancelled. These include the additional obligations resulting from the submission of rectifying returns that correct the outstanding principal payment obligations due prior to September 30 2015 and obligations resulting from the correction of VAT returns.

For those accessories obligations referring to the principal amounts paid by September 30 2015, the tax incentive will apply only if these accessories obligations have not been paid.

The tax incentive also applies to:

- taxpayers who benefited from rescheduling payments according to GEO 29/2012, approved by Law no. 15/2012, if the scheduling is completed by 31 March 2016;
- taxpayers who, as of 31 March 2016, have pending reimbursement applications for which, subsequently, the tax authority totally or partially rejected the refund. In this case, the payment obligations on which the cancellation depends must be paid within 30 days from when the decision to reject the reimbursement was communicated.
- accessories obligations referring to the principal amounts due until 30 September 2015, mentioned in a tax decision resulted from a tax audit which is ongoing when the present GEO is enforced. In this case, the cancellation request is submitted in 90 days since the tax decision is communicated.

If payment obligations are due to local budgets, the provisions of this GEO would apply by decision of the city council.

Taxpayers can notify their intention to benefit from the tax incentive, in which case the tax authorities would issue decisions for delay of payment.

The application procedures will be published within 30 days from when the GEO enters into force.

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