

# Asia Pacific Tax Adviser

Grant Thornton 

A quarterly round up of recent tax developments in the Asia Pacific region

This third edition of the Asia Pacific Tax Adviser focuses on Transfer Pricing and the supply chain approach with updates on regulations from around the region. Grant Thornton International member firms throughout the Asia Pacific region work closely to provide the best possible service for clients. If you require assistance concerning any of the issues raised, please contact your local member firm or [gary.james@gthk.com.hk](mailto:gary.james@gthk.com.hk).

## Transfer pricing services

Businesses that are growing need to examine their related party transactions to ensure that they comply with the transfer pricing laws of each country in which they operate.

Transfer pricing laws generally prescribe that international related party transactions be undertaken on a commercially justifiable "arm's length" basis in order not to shift taxable profit from one jurisdiction to another. The rules potentially apply to the movement of all goods and services, including the use of tangible/intangible assets.

"It is an increasingly complex issue for businesses in the Asia Pacific region, as more countries are recognising the importance of the issue and are developing their transfer pricing laws," explains Rohan Phatarphekar, head of Asia Pacific Transfer Pricing. "Clients need to receive local advice from experts in this area to ensure that they satisfy all local laws."

Grant Thornton International member firms work primarily in three main areas of transfer pricing:

- documentation
- planning
- defence

## Documentation

Most countries have their own documentation rules and they change from time to time. Penalties for incorrect documentation can be severe so it is important to keep up to date with the latest rules and issues to ensure that documentation is correct.

## Planning

The growth or restructuring of a company doing international business can provide a good opportunity to review transfer pricing and international tax planning. Specialists from Grant Thornton member firms have considerable expertise in managing this change of policy. This process can actually bring about tax savings. Refer to the comments below on

the supply chain approach as an example of planning opportunities.

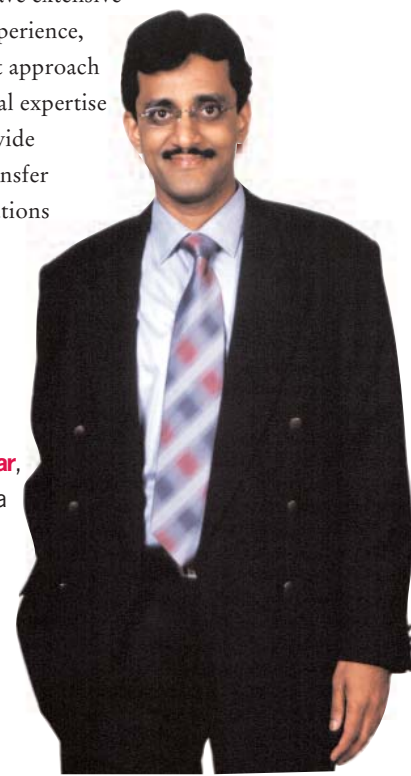
## Defence

Defence of transfer pricing disputes can take a long time to resolve and inevitably involves going back through old records. Specialists can use sophisticated economic arguments, research and databases to provide the highest calibre of substantiation for positions that have been taken.

## International expertise

Grant Thornton International member firms employ focussed transfer pricing specialists in all regions who interact with each other to build up a knowledge bank that is shared around the world. Teams are focussed, have extensive practical experience, use a robust approach and technical expertise to help provide effective transfer pricing solutions for clients.

**Rohan Phatarphekar,**  
Head of Asia Pacific Transfer Pricing



## Transfer Pricing updates for the Asia Pacific region

### Australia

The 2005/06 Compliance Program outlines the Australian Taxation Office's (ATO's) expected activities for the coming 12 months. The ATO will be focussing on income tax risk review and audit work involving profit-shifting arrangements. The ATO has previously conducted reviews on wholesale distributors. It now intends to broaden the focus of the review program by examining transfer pricing issues in other areas of the SME segment.

This year the ATO expects to conduct 40 reviews and commence 25 audits focusing on profit-shifting arrangements. It also anticipates entering into advance pricing arrangements with 12 SMEs.

The ATO will also be focussing more on the inappropriate use of tax havens and bank secrecy regimes. A range of information sources, including AUSTRAC data, return forms and information from other tax administrations, play an important role in helping it identify appropriate cases for audit.

The ATO has released a draft ruling and guidance manual dealing with the use of service trusts by professional service firms. The ATO have prescribed the performance of functional analysis to justify the fairness of the fees being charged to the professional services firm. Transfer pricing methodologies had previously only been used to attack cross-border transactions and this illustrates the increasing reliance on economists within the ATO to identify high risk audit targets.

### Hong Kong

Since 25 June 2004, sums which are received or accrued to a non-resident person for the use of or right to use various intellectual properties (eg patent, design, trademark, copyright material etc) outside Hong Kong which are deductible in ascertaining a person's assessable profits for Profits Tax purposes, have been deemed to be taxable receipts.

The Inland Revenue Department has amended the following Departmental Interpretation and Practice Notes (DIPNs) to outline its practice following the change in legislation:

- DIPN 17 – Taxation of persons chargeable to Profits Tax on behalf of non-residents;
- DIPN 22 – Computation of assessable profits from cinematograph films, patents, trademarks.

### India

The Indian Tax Authorities are continuing to conduct detailed transfer pricing audits.

### Japan

Under new law, "foreign related parties" for transfer pricing purposes will include the following foreign corporations:

- A foreign corporation which is associated with a Japanese corporation through:
  - substantial control and 50% or more ownership; or
  - indirect substantial control only.

- A foreign corporation which is directly or indirectly controlled by the same person through:
  - substantial control and 50% or more ownership; or
  - substantial control only.

This change intends to treat all foreign corporations as "foreign related parties" if the corporation is associated with a Japanese corporation directly or indirectly by either ownership or substantial control.

For example, if there is an ownership of 50% or more or substantial control between a Japanese corporation and a foreign corporation, the foreign corporation is treated as a "foreign related party". Under the current transfer pricing rules any other corporation controlled by the foreign corporation is not a "foreign related party". Under the proposed change, the second corporation also becomes a "foreign related party".

This change is important to ensure that appropriate documentation is retained for all related party transactions.

In recent months it has been noted that there has been a marked increase in the level of audit activity on transfer pricing by the tax authorities in Japan and such reviews are no longer reserved for the largest multinationals.

### New Zealand

The New Zealand Inland Revenue continues to issue transfer pricing questionnaires and undertake transfer pricing audits as part of its transfer pricing work programme.

### Philippines

In the Philippines the Tax Court has allowed lower prices to foreign affiliates. The Philippine Court of Tax Appeals (CTA) has ruled that a lower commission rate (compared to charges to a local client) charged by a Philippine stock broker company to its foreign affiliate can still be considered arm's length. This applies when the foreign affiliate performs certain services for the Philippine company placing it under different circumstances to the other companies not performing similar services. If the services were the same, they would be required to charge the same rate of commission.

In another case, the Court ruled that the price of a company's export sales may be lower than its local sales and still be considered an "arm's length price" when the price difference is not attributable to the relationship between the affiliated companies but to market competitiveness and the need to maximise productivity levels, secure dollars to fund its importations, and meet export quota to qualify for incentives.

### Taiwan

The Ministry of Finance announced new transfer pricing regulations, outlining a new related policy definition and prescribing the transfer pricing methodologies to be used for both

tangible and intangible property. The new regulation was announced towards the end of 2004 and is expected to be strictly enforced in 2005. Of importance is the requirement to submit to the tax inspector, within 30 days of his request, a transfer pricing study report, which includes the following:

- A comprehensive business overview, including history, structure, main business activities and analysis of economic and legal factors that affect transfer pricing;
- A description of the organisational structure, including organisational charts of all affiliates, register of directors, supervisors;
- Summaries of all related parties transactions, including types, procedures, dates, contract terms, and purposes of transactions;
- Transfer pricing contemporaneous documentation report incorporating:
  - industry and economic analysis;
  - functional and risk analysis of taxpayer and all affiliates which have intercompany transactions with the taxpayer;
  - a description of the arm's-length pricing analysis;
  - all supportive evidence of comparables selected and the relevant data;
  - an economic analysis based on the degree of comparability and quality of underlying data and assumption;
  - a description of the best method selection process and an explanation as to why other TPMs were not selected;

- pricing methods adopted by affiliates and related information; and
- all relevant calculations and financials used to support the selected method.

- Reports regarding the relationship between all affiliates which indicate legal acts, funds flow, and profit/loss status (both independent and consolidated reports); and
- Other documents in relation to related parties transactions, which may affect pricing, if any.



**Peter Godber,**  
Partner, Grant  
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Australia

# Transfer Pricing and the Supply Chain

Many international trading and business structures have evolved over time with the result that the trading and business structure is overly complicated and administratively, operationally and logistically inefficient. Part of the reason for such overly complicated structures has been taxation driven, but with tax authorities increasingly becoming more sophisticated and looking at the motive behind structures and transactions, it is not surprising that many companies are now left with tax structures that attract scrutiny.

What is needed is a more holistic solution that looks at the business as a whole and a value or supply chain approach is often the most effective way to proceed.

The response is often to simplify structures and processes and embrace technology to drive efficiency. Part of the response may also be to consider which parts of the business value chain your company does best and to seek trading partners and relationships to fill in the gaps. It is not surprising then, that companies seeking cost savings and process improvements are increasingly considering locating some of their functions off shore as part of the solution. This may often be combined with

the outsourcing of certain parts of the value chain.

The key is to understand the links in the chain, from procurement and manufacturing to distribution, sales and after sales, product and brand development, management, administration and funding to identify the real contribution of each business unit to total profit and hence establishing the correct transfer pricing policies for a business. A detailed functional analysis facilitates this understanding by identifying the functions performed, assets employed and risks borne by the different business units within the group at each stage of the supply chain.

Generally speaking, the greater the functions performed, assets employed and risks borne by a part of the business, the greater would be its expected share of profits of the group. As a business restructuring will probably impact on these factors, the expected profitability of each part of the business is likely to change.

The presence of robust transfer pricing documentation which supports the chosen business structure will be essential and

should be seen as a key element in the risk management process.

As a by product of the transfer pricing driven approach to supply chain restructuring, it may be possible to achieve group taxation changes, for example by taking advantage of a friendly tax regime that encourages in bound investment. This is particularly true of the Asia Pacific region, given the wide divergence of tax systems, practice and tax rates. However, it is stressed that taxation should not dictate the structure and the supply chain considerations.

Therefore, while the overall aim of the international tax planner is to achieve a lower overall tax burden around the world, the approach must consider the whole value chain, from design, manufacture and supply all the way through to sales and delivery to the customer.

The supply chain approach has been successfully adopted by many multinational companies who have sought to restructure their affairs to achieve cost reductions and become more competitive.

If you would like to find out more about how Grant Thornton member firms can assist you, please contact one of the divisional offices, or visit [www.gti.org](http://www.gti.org)

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