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Assessment Rules for Non-Arm's Length Transfer Pricing of Profit-Seeking Enterprises

On December 28, 2004, the Taiwanese Ministry of Finance promulgated new transfer pricing regulations, the "Assessment Rules for Non-Arm's Length Transfer Pricing of Profit-Seeking Enterprises" ("new transfer pricing rules"). As a result, taxpayers are now required to submit the documents listed below, as well as their income tax return certified by public accountants, effective for tax returns filed from the fiscal year 2004 or after (for example, a corporation whose fiscal year ends in December 2004 must comply with the new transfer pricing rules when filing its tax return in May 2005, whereas a corporation whose fiscal year ends in March 2005 must do so when filing its tax return in August 2005).

The transfer pricing rules require a taxpayer to attach the following four types of document to its tax return as explanation for its controlled transactions:

1. Schedule of the enterprise and its related parties

- (1) Ownership structure of the enterprise, and capital relationship with its related parties
- (2) Business outline of the enterprise and its related parties as of the relevant fiscal year

2. Schedule of each controlled transaction between the enterprise and its related parties

- (1) Summary (noting the transfer pricing method applied to each related party transaction)
- (2) Details (including a comparison of the related party transaction with any uncontrolled transactions engaged in by the enterprise)

It is interesting to note that the new transfer pricing rules require a taxpayer to file an attachment to the tax return stating the transfer pricing methods applied, just as required in Schedule 17(3) attached to Japanese tax returns. Acceptable transfer pricing methods in Taiwan are set out in articles 10 to 13 of the new transfer pricing rules, for tangible property transactions, intangible property transactions, service transactions, and transactions involving the use of funds. Taxpayers must choose a transfer pricing method prescribed by the new transfer pricing rules.

In this regard, a Japanese corporation engaging in foreign-related transactions with a Taiwanese affiliate should ensure that the transfer pricing method reported by the corporation in its tax

returns is consistent with the method reported by its affiliate in Taiwan. However, if the transfer pricing methods applied by the corporation and its Taiwanese affiliate are different, and the entities change either of the methods stated in the tax return for consistency, the change is likely to attract the attention of the Japanese and Taiwanese tax authorities.

Article 22 of the new transfer pricing rules stipulates that documents that must be presented by taxpayers in transfer pricing audits as follows:

1. Comprehensive business overview

- (1) History
- (2) Main business activities
- (3) Analysis of economic, legal and other factors affecting transfer pricing

2. Organization structure

- (1) Organizational charts of all affiliated companies (both domestic and foreign)
- (2) List of directors, supervisors and other management members (as well as information on personnel changes in these positions over the period covered by the audit, plus one year before and one year after)

3. Summary of related party transactions

- (1) Type, procedure, date, object and quantity
- (2) Contract terms
- (3) Purpose of transaction (including whether a sale or license; and the impact of controlled transactions)

4. Transfer pricing report

- (1) Industry and economic analyses
- (2) Functional and risk analyses
- (3) Transfer pricing method
- (4) Comparable transactions selected and relevant data

If a transfer pricing audit commences in fiscal year 2004, the documents listed in 1. to 3. must be provided by a taxpayer within one month upon request by the tax authorities. For transfer pricing audits commencing in fiscal 2005 and beyond, a taxpayer must submit a transfer pricing report as indicated in 4. If requested documents are written in a foreign language, a Chinese translation of the documents must accompany the submission.

A literal interpretation of the new transfer pricing rules, as explained above, is that a taxpayer must prepare and provide the required documents at the time of filing of their tax return, or in the case of a transfer pricing audit. However, given that it would be extremely difficult for a taxpayer to prepare such documents, including translations in Chinese, within one month of commencement of an audit, the new transfer pricing rules are assumed to require taxpayers to produce transfer pricing documents that may be required in advance of an audit.

As readers may be aware, transfer pricing issues involve more than one country. In particular, because there is no tax treaty between Japan and Taiwan, if a tax assessment is made in either country in relation to a controlled transaction between them, and that assessment results in double taxation, it would be extremely difficult for the taxpayers to eliminate that double taxation, as they would have no alternative but to seek a resolution within the framework of domestic law. Therefore, it is recommended that Japanese corporations undertaking foreign-related transactions with Taiwanese entities prepare and maintain documents required under the new transfer pricing rules in advance of an audit, and take measures to mitigate transfer pricing risk and avoid transfer pricing audits based on a global transfer pricing strategy.

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For further information, please contact Yasuko Takahashi or Mayumi Nakamura at:

E-mail: pwcjapan.taxpr@jp.pwc.com Tel:03-5251-2400