



Transfer pricing audit readiness

Are you ready for an audit of your company? Will this result in double taxation, interest, and penalties?

This newsletter highlights the importance of the comprehensive transfer pricing documentation as a defense in tax audits.

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Transfer pricing audits

Transfer pricing (“TP”) has become a key tax issue that will impact business operations, costs of the business and certainty of tax positions. Improper transfer pricing arrangements may trigger double (or even triple) taxation as well as significant penalties and interests.

First TP audit by the Mongolian Tax Administration

The Organization for Economic Cooperation and Development (the “OECD”) announced that the Mongolian Tax Administration (“MTA”) issued its first TP tax assessment of approximately USD 228 million. As stated in the OECD’s (<https://www.oecd.org/tax/mongolian-tax-administration-partners-with-international-organisations-and-issues-first-transfer-pricing-tax-assessment-for-usd-228-million.htm>) and the MTA’s (http://www.mta.mn/c/view/800_34) websites, this tax assessment was results of long term technical assistance projects from the OECD, the Intergovernmental Forum on Mining, Minerals, Metals, and Sustainable Development, the United Nations Development Programme and the OECD’s Tax Inspectors Without Borders programme.

Although, the public information refers this tax assessment as being under the dispute, the OECD emphasizes its significance in combating base erosion and profit shifting in the mining sector, aligning the tax rules with the international best practices.

Tax audit regulation

On 15 April 2021, the Mongolian Tax Administration revised the “Tax audit regulation”. Based on the revised regulation, the tax audits by the tax authorities are classified as ordinary, simplified, and comprehensive.

Ordinary and/or simplified tax audits can be re-classified and changed to comprehensive tax audits, if tax inspectors see a potential risk. A “comprehensive” type of audit involves application of the general anti-avoidance tax rules, TP rules, etc. If a pricing applied by a particular taxpayer in a related party transaction differs from a pricing applied by a comparable independent party transacting in similar comparable conditions, then the tax authorities can make a primary and secondary TP adjustments in accordance with TP legislation. There is no distinctive timing for a TP inspection, it can take longer than the ordinary tax inspection.



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TP adjustments

If taxpayers did not prepare TP reports, or reduced a tax base as a result of the intercompany arrangements, the tax authorities will make a primary TP adjustment and reassess a tax. For corporate income tax or personal income tax purposes, differences arising as a result of the primary adjustment will be treated as a dividend and taxed accordingly as a secondary TP adjustment. There is no specific TP penalty, the general tax penalty applies for non-compliance.

If a taxpayer makes a comparability adjustment, such adjustment shall be supported by a source of information and other documents. Unless the tax authorities follow mutual agreement procedure in accordance with international tax agreements and regulation, it is hardly possible that they accept an adjustment that reduces taxable base.

Typical transactions and TP issues

Certain transactions among related parties such as financing, royalties, management services fees, expense allocations for shared services can be closely scrutinized during TP audits.

For such activities, taxpayers should consider maintaining documentation that proves an arm's length nature of the arrangement, supporting contracts and documents, an appropriate policy for allocation of expenses.

TP documentation readiness

Starting from 2020, the TP documentation became a mandatory compliance requirement in Mongolia, which generally includes a Master File, a Local File and Country-by-Country Reporting, and a TP transactional annual report. It is common for the tax authorities to make reference to taxpayers' documentation when selecting audit targets. Therefore, effective documentation can serve as a first line of defense for taxpayers to potential queries and challenges from tax authorities.

Comprehensive TP documentation can reduce TP audit risk, and can improve the speed of audit resolution by demonstrating a low level of compliance risk.

Most importantly, the TP documentation as a defense file should reduce the risk of disputes and defense costs and help to strengthen tax position of a taxpayer.

TP legislation effective from January 2020

To prevent TP risks during TP audits, companies must comply with the following TP legislation that has been in effect from 2020:

- The General Tax Law of Mongolia dated 22 March 2019: <https://www.legalinfo.mn/law/details/14403?lawid=14403>
- The Corporate Income tax Law dated 22 March 2019: <https://www.legalinfo.mn/law/details/14407?lawid=14407>
- "The Regulation on TP adjustment and selection of TP methods" approved by the Ordinance # 308 of the Minister of Finance and dated 31 December 2019: <https://www.legalinfo.mn/annex/details/10548?lawid=15010>
- "The Transfer pricing reporting templates and guidelines", approved by the Ordinance of the Commissionaire of General Tax Department No. A/133 and dated 3 September 2020: <https://www.legalinfo.mn/annex/?lawid=15641>

How PwC can help you

Compliance:

- Prepare / localize / update transfer pricing documentation for all types of transactions
- Prepare benchmarking studies for prices, profitability margins, interest rates, royalty
- Prepare annual transactional TP report, Local File, Master File and CbCR

Day-to-day support:

- Diagnostics of transfer pricing risks
- Develop transfer pricing policies and procedures, train in-house specialists
- Assist with transfer pricing matters ad-hoc

Planning and transformation:

- Structure your business in a tax efficient way
- Align transfer pricing with your business model
- Attribute profit to a permanent establishment appropriately

Position defense and dispute resolution:

- Develop defense strategy and argumentation
- Support during tax audits and coordinate positions with tax authorities
- Support during tax appeals
- Assist with mutual agreement procedures