Safe harbour rules in transfer pricing (2) (2/25/18)

This article completes our series on this topic.

Practical application of safe harbour rules

Although the safe harbour principle has been debated for many years, only a few countries have put it into practice,[1] mainly because of risks outlined in our earlier articles, such as double taxation, aggressive tax planning, and one country's safe harbour being ignored by the other country.

A 2012 OECD survey reveals that in countries that have adopted the safe harbour principle 35% of cases involve an exemption from transfer pricing analysis, 26% are simplified transfer pricing solutions and a safe harbour for arm's length rates (ranges), while 13% provide a safe harbour for interest rates on financing transactions. When looking at types of controlled transactions usually covered by the safe harbour principle, the OECD survey finds transfer pricing relief for low-value-adding intragroup services in 30% of cases, intragroup financing transactions in 26%, small and medium companies' transactions in 22%, and transactions that do not exceed a stated materiality threshold in 9% of cases.

Below we summarise how various countries have put the safe harbour principle into practice:

- Australia offers a safe harbour (1) to small taxpayers and distributors with revenue not exceeding a stated threshold, (2) to low-value-adding intragroup services, and (3) to small loans not exceeding a stated threshold. A markup of 7.5% can be applied on intragroup services, while intragroup interest rates should not exceed the Reserve Bank of Australia rate for small companies.
- The Czech Republic offers a safe harbour for low-value-adding intragroup services.
- Hungary applies the safe harbour principle to small and medium companies as well as low-value-adding intragroup services, setting a markup of 3–10%.
- Liechtenstein offers a safe harbour for intragroup interest payments determined by tax authorities.
- Mexico-registered branches of foreign production companies apply so-called Maquiladora rules.
- Singapore applies the safe harbour principle by setting a 5% markup on ordinary support services. There is also a range of interest rates the taxpayer can apply on loans not exceeding a stated threshold.
- Switzerland offers a safe harbour for intragroup loan interest payments.
- The US offers a safe harbour for intragroup financing transactions. Loans to related parties are eligible for the US government's federal rate published by tax authorities each month. Low-value-adding intragroup services also qualify for a safe harbour.

In summary a safe harbour is available in several countries and in various industries to simplify the formulation of rules governing controlled transactions, to improve the conditions for transfer pricing analysis, and to release taxpayers from future transfer pricing reviews and audits. Also, the safe harbour rules increase tax certainty because tax authorities have to accept any prices set for controlled transactions according to this solution.

Relevant Latvian ministries are expected to evaluate and proposed alternatives in terms of relaxed requirements for defending transfer prices in specified transactions, which will be passed into the applicable legislation.

[1] Australia, Brazil, Czech Republic, South Africa, Hungary, India, Liechtenstein, Luxembourg, Mexico, New Zealand, Russia, Singapore, Slovenia, Spain, Switzerland, USA, and Uruguay.