

Liability for transfer pricing breaches (3/47/20)

The amended transfer pricing ("TP") rules effective from 2018 authorise the State Revenue Service ("SRS") to penalise taxpayers for TP breaches. This article explores when the SRS can impose a penalty and what procedures are in place to keep it in proportion.

Revised TP documentation rules

Amendments to section 15.2 of the Taxes and Duties Act, which apply to transactions made in reporting periods beginning in 2018 or later and which recast the TP documentation rules, require a taxpayer to prepare specific documentation that gives necessary details for describing the taxpayer's business and related-party transactions, identifying TP methods, and evaluating compliance with TP rules.

Penalties

The amendments prescribe liability for breaching TP documentation requirements. The SRS has the power to impose a penalty on the taxpayer where it is impossible to verify that the price (value) of a controlled transaction between related parties is arm's length. The penalty covers two types of breach: non-compliance and inadequate compliance. A penalty can be imposed if –

- the taxpayer has missed the deadline for filing TP documentation;
- the documentation filed omits any of the required details.

The rules for preparing and filing TP¹ documentation provide for a penalty –

- up to 1% of the controlled transaction;
- capped at EUR 100,000.

Comment on penalty

PwC asked the SRS to comment on how the penalty is to be calculated where a breach affects two or more controlled transactions. The SRS commented as follows:

- A penalty can be imposed for each controlled transaction that is covered by the taxpayer's obligation to prepare TP documentation and included in his revenue or expense for the financial year if he has neglected to file TP documentation for the transaction by the statutory deadline or if the documentation filed omits some essential information, making it impossible to verify that the price (value) of the transaction is arm's length;
- The penalty for each controlled transaction cannot exceed EUR 100,000;
- Where a breach affects two or more controlled transactions, the penalties for those transactions can be added up to exceed EUR 100,000.

Example

If three controlled transactions in various categories made during a financial year required the taxpayer to prepare and submit a local TP file within 12 months after the end of that year, but he has defaulted on this obligation for various reasons, the maximum penalty is EUR 300,000.

It is important to note that on a tax audit the SRS will actually be able to make a TP adjustment in addition to the penalty.

Comment on proportionality

The SRS also invoked the initial impact assessment report ([annotation](#)) to the proposed amendments and stated that in drafting this penal provision the legislature had evaluated the threshold for imposing a penalty and found that the level of liability for a substantial breach of the TP documentation requirement or for a missed filing deadline is proportionate because the amount of unpaid CIT depends on the amount of the controlled transaction. The penalty is substantially lower than the exposure the controlled transaction causes to the government as a result of TP risk.

The rule of law doctrine dictates that penalties should be proportionate. Where a disproportionate penalty has been imposed, it must be overturned. The problem lies in the penal rules being silent as to when a penalty is considered proportionate and what level makes it disproportionate.

Although statistics on penalties imposed for TP breaches are not currently available to the public, we hope that the SRS will objectively evaluate risk levels in proportion to breaches and that this instrument will only serve to dissuade taxpayers from wrongdoing.

¹ [Section 15.2\(14\) of the Taxes and Duties Act](#)