



REPUBLIC OF NAURU
GOVERNMENT GAZETTE
PUBLISHED BY AUTHORITY
EXTRAORDINARY

No. 204

04th November 2016

Nauru

G.N. No. 896 / 2016

Business Tax (Transfer Pricing) Regulations

SL No. [27] of 2016

Notified: []

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Cabinet makes the following regulations under section 46 of the *Business Tax Act 2016* for the purposes of section 34 of the *Business Tax Act 2016*:

PART 1 - PRELIMINARY

1. Short Title

These Regulations may be cited as the *Business Tax (Transfer Pricing) Regulations 2016*.

2. Commencement

- (1) Subject to sub-regulation (2), these Regulations commence on 1 July 2016.
- (2) The Minister may specify a later date than that specified in sub-regulation (2) for Regulation 11 to come into force.

3. Definitions

- (1) In these Regulations:

‘**Act**’ means the Business Tax Act 2016;

‘**arm’s length principle**’, in relation to a controlled transaction, means that the result of the transaction is consistent with the result that would have been realised in a transaction between independent persons dealing with each other under the same or similar conditions;

‘**comparability factors**’ means the factors specified in Regulation 3;

‘**comparable uncontrolled price method**’ means the transfer pricing method under which the price charged in a controlled transaction is compared with the price charged in a comparable uncontrolled transaction;

‘**comparable uncontrolled transaction**’, in relation to the application of a transfer pricing method to a controlled transaction, means an uncontrolled transaction that, after taking account of the comparability factors, satisfies the following:

- (a) the differences, if any, between the two transactions or the between the persons undertaking the transactions do not materially affect the financial indicator applicable under the method; or
- (b) if the differences referred to in paragraph (b) do materially affect the financial indicator applicable under the method, reasonably accurate adjustments can be made to eliminate the effects of such differences;

‘**controlled transaction**’ means a transaction between associates;

‘**cost plus method**’ means the transfer pricing method under which the mark up on the costs directly and indirectly incurred in the supply of property or services in a controlled transaction is compared with the mark up on those

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costs directly or indirectly incurred in the supply of property or services in a comparable uncontrolled transaction;

'financial indicator' means:

- (a) in relation to the comparable uncontrolled price method, the price;
- (b) in relation to the cost plus method, the mark up on costs;
- (c) in relation to the resale price method, the resale margin;
- (d) in relation to the transaction net margin method, the net profit margin; or
- (e) in relation to the transactional profit split method, the division of profit and loss;

'person' includes a "PE person" and "headquarters person" as defined in Regulation 4;

'resale price method' means the transfer pricing method under which the resale margin that a purchaser of property in a controlled transaction earns from reselling the property in an uncontrolled transaction is compared with the resale margin that is earned in a comparable uncontrolled purchase and resale transaction;

'transaction' means:

- (a) a purchase and sale of goods;
- (b) a purchase, sale, lease, or use of tangible property;
- (c) a purchase, sale, licence, or use of intangible property;
- (d) a provision of services;
- (e) a provision of finance or other financial arrangement;
- (f) a dealing between a permanent establishment of a person and another part of the person;
or
- (g) any other dealing;

'transactional net margin method' means the transfer pricing method under which the net profit margin relative to the appropriate base (such as costs, sales, or assets) that a person achieves in a controlled transaction is compared with the net profit margin relative to the same basis achieved in a comparable uncontrolled transaction;

'transactional profit split method' is the transfer pricing method under which the division of profit and loss that a person achieves through participation in a controlled transaction is compared with the division of profit and loss that would be achieved when participating in a comparable uncontrolled transaction;

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'transfer pricing method' means:

- (a) the comparable uncontrolled price method;
- (b) the resale price method;
- (c) the cost plus method;
- (d) the transaction net margin method; or
- (e) the transactional profit split method; and

'uncontrolled transaction' means a transaction that is not a controlled transaction.

- (2) Without limiting the generality of the definition of *'associate'* in the Act, in addition, two persons are associates when:
 - (a) one person participates, directly or indirectly, in the management, control, or capital of the other person; or
 - (b) the same person participates, directly or indirectly, in the management, control, or capital of both persons.
- (3) For the purposes of sub-regulation (2), a person participates, directly or indirectly, in the management, control, or capital of another person when:
 - (a) the first-mentioned person either alone or together with an associate or associates under another application of sub-regulation (2) controls either directly or through one or more interposed persons:
 - (i) fifty per cent or more of the voting power in the second-mentioned person;
 - (ii) fifty per cent or more of the right to dividends or income entitlements payable by the second-mentioned person;
 - (iii) fifty per cent or more of the right to capital in the second-mentioned person; or
 - (b) the first-mentioned person has the practical ability to control the business decisions of the second-mentioned person.
- (4) A term used in these Regulations has the same meaning as in the Act unless the context requires otherwise.

4. Comparability factors

In determining whether two or more transactions are comparable, the following factors are considered to the extent that they are economically relevant to the facts and circumstances of the transactions:

- (a) the characteristics of the property or services transferred or supplied;

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- (b) the functions undertaken, assets used, and risks assumed by the parties to the transactions;
- (c) the contractual terms of the transactions;
- (d) the economic or market conditions in which the transactions take place;
- (e) the business strategies pursued by the parties to the transaction.

5. Permanent establishments

- (1) Subject to sub-regulation (2), for the purposes of these Regulations:
 - (a) a permanent establishment is deemed to be a separate and distinct person (referred to as the “PE person”) from the person in respect of whom it is a permanent establishment (referred to as the “headquarters person”);
 - (b) the PE person and headquarters person are deemed to be associates; and
 - (c) a PE person and a headquarters person are located where their activities are located.
- (2) The Secretary may choose not to apply this Regulation if the foreign country in which the headquarters person is located does not apply the same rule as that expressed in sub-regulation (1).

6. Relevance of OECD material to interpretation of these Regulations

- (1) Subject to sub-regulation (2), these Regulations are to be applied in a manner consistent with:
 - (a) the arm’s length principle in Article 9 of the OECD Model Tax Convention on Income and Capital; and
 - (b) the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, as approved by the Council of the Organisation for Economic Cooperation and Development, as supplemented and updated from time to time.
- (2) If there is any inconsistency between these Regulations and the OECD documents referred to in sub-regulation (1), these Regulations prevail.

7. Application of Regulations

- (1) Subject to sub-regulation (2), these Regulations apply to a controlled transaction between:
 - (a) a resident person and a non-resident person;
 - (b) two or more resident persons; or

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- (c) a permanent establishment of a non-resident person in Nauru and a non-resident person outside Nauru.

(2) These Regulations do not apply to a controlled transaction that takes place wholly in Nauru.

PART 2 – APPLICATION OF THE ARM’S LENGTH PRINCIPLE

8. Transactions to be consistent with the arm’s length principle

- (1) The application of this Regulation is subject to Regulations 8 and 9.
- (2) When a taxpayer has entered into a controlled transaction or a series of controlled transactions to which these Regulations apply, the taxpayer must determine the amount of gross revenue derived, and expenditures incurred, in relation to the transaction or transactions in a manner that is consistent with the arm’s length principle.
- (3) The amount of gross revenue derived, and expenditures incurred, by a taxpayer from a controlled transaction or transactions must be consistent with the arm’s length principle if the conditions of the transaction or transactions do not differ from those that would have applied in a comparable uncontrolled transaction.
- (4) If the amount of gross revenue derived, or expenditures incurred, by a taxpayer from a controlled transaction or transactions are not consistent with the arm’s length principle, the Secretary may make such adjustments as necessary to ensure consistency with the arm’s length principle.
- (5) The determination of the whether the amount of gross revenue derived, and expenditures incurred, by a taxpayer from a controlled transaction or transactions are consistent with the arm’s length principle must be made by using the most appropriate transfer pricing method or a combination of methods having regard to the following:
 - (a) the respective strengths and weaknesses of the transfer pricing methods having regard to the circumstances of the case;
 - (b) the appropriateness of a transfer pricing method taking account of the nature of the controlled transaction determined, in particular, through an analysis of the functions undertaken, assets used, and risks assumed by each person that is a party to the controlled transaction;
 - (c) the availability of reliable information needed to apply the transfer pricing methods;
 - (d) the degree of comparability between controlled and uncontrolled transactions, including the reliability of adjustments, if any, that may be required to eliminate any differences.
- (6) If, having regard to sub-regulation (5), a taxpayer has used an appropriate transfer pricing method, the Secretary’s determination as to whether the amounts of gross revenue and expenditures arising from the transaction or

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transactions are consistent with the arm's length principle must be based on the transfer pricing method used by the taxpayer.

- (7) A taxpayer may apply a transfer pricing method other those listed in the definition of "transfer pricing method" in Regulation 3 to a controlled transaction if the taxpayer can establish that:
- (a) none of the listed methods can reasonably be applied to determine whether the controlled transaction is consistent with the arm's length principle; and
 - (b) the method used gives rise to a result that is consistent with that between independent persons engaging in comparable uncontrolled transactions in comparable circumstances.

9. Services

- (1) Subject to sub-regulation (2), in determining whether a service fee charged by a taxpayer in a controlled transaction is consistent with the arm's length principle, the Secretary must have regard to the following:
- (a) whether the services have actually been provided;
 - (b) whether the services provide, or will provide, the recipient with economic or commercial value that will enhance its commercial position;
 - (c) whether an independent person in comparable circumstances would be willing to pay for the services, or would be willing to perform the services for itself in-house;
 - (d) whether the fee corresponds to the fee that would have been agreed between independent persons for comparable services in comparable circumstances.
- (2) A service fee paid or payable by a company to an associated company is not consistent with the arm's length principle when the fee is for any of the following costs incurred or activities undertaken by the associated company:
- (a) costs or activities relating to the juridical structure of the associated company, such as shareholder meetings, the issuing of shares, or the costs of the associated company's board of directors;
 - (b) costs or activities relating to the reporting requirements of the associated company, including the preparation of consolidated financial reports;
 - (c) costs or activities relating to the raising of funds by the associated company, except to the extent that the first-mentioned company benefits from the funds.

10. Intangibles

In determining whether the consideration for a licence, sale, or other transfer of intangible property by a taxpayer in a controlled transaction is consistent with the arm's length principle, the Secretary must have regard to the following:

- (a) the value and usefulness of the intangible property to the business of the transferee;
- (b) the price for which an independent person in similar circumstances of the transferor would be willing to transfer the property;
- (c) the expected benefits to the transferee of the property;
- (d) any geographical limitation on the use of the property by the transferee;
- (e) whether the transferee's use of the property is exclusive or non-exclusive;
- (f) whether the transferee has the right to participate in the further development of the property by the transferor.

PART 3 – DOCUMENTATION

11. Documentation

- (1) A taxpayer must have in place contemporaneous transfer pricing documentation as specified in Schedule 1 that verifies that the conditions in the taxpayer's controlled transactions for a tax year are consistent with the arm's length principle.
- (2) The transfer pricing documentation of a taxpayer for a tax year is considered to be contemporaneous when it is prepared prior to the due date for filing the taxpayer's business profits tax return for the year.
- (3) A taxpayer must, upon written request by the Secretary, provide the taxpayer's transfer pricing documentation to the Secretary within 30 days of service of notice of the request or within such further time as the Secretary may allow.
- (4) The record-keeping obligations of a taxpayer specified in this Regulation are in addition to any record-keeping obligation applicable to the taxpayer under the Act or the *Revenue Administration Act 2014*.

PART 4 – ADVANCED PRICING AGREEMENTS

12. Advance pricing agreements

A taxpayer may request that the Secretary enter into an advance pricing agreement to establish an appropriate set of criteria for determining whether the taxpayer has complied with the arm's length principle for specified future controlled transactions undertaken by the taxpayer over a fixed period of time.

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(1) A request under sub-regulation (1) must be accompanied by:

- (a) a description of the taxpayer's activities, controlled transactions, and the proposed scope and duration of the advanced pricing agreement;
- (b) a proposal by the taxpayer for the determination of the transfer prices for the transactions to be covered by the advanced pricing agreement setting out:
 - (i) the comparability factors;
 - (ii) the selection of the most appropriate transfer pricing method for the circumstances of the controlled transactions; and
 - (iii) the critical assumptions as to future events under which the determination is proposed;
- (c) the identification of any other country or countries that the taxpayer wishes to participate in the advanced pricing agreement; and
- (d) any other information that the Secretary may require as specified in a public ruling on transfer pricing.

(3) The Secretary must consider a request by a taxpayer under sub-regulation (1) and, after taking account of the matters specified in the request and the expected benefits from an advance pricing agreement in the circumstances of the case, the Secretary may decide to enter into an advance pricing agreement or to reject the request.

(4) If the Secretary agrees to enter into an advance pricing agreement with a taxpayer, the Secretary may accept the taxpayer's proposal under sub-regulation (2)(b), reject it, or modify it with the taxpayer's consent.

(5) The Secretary may enter into an advance pricing agreement with the taxpayer either alone or together with the competent authority of the country or countries identified under sub-regulation (2)(c).

(6) If the Secretary approves a proposal under sub-regulation (2)(b) or modifies it with the taxpayer's consent, the Secretary must enter into an advance pricing agreement that will provide confirmation to the taxpayer that no transfer pricing adjustment will be made under Regulation 7(4) to a controlled transaction covered by the agreement provided the transaction is consistent with the terms of the agreement.

(7) An advance pricing agreement entered into under sub-regulation (6) applies to the controlled transactions specified in the agreement that are entered into on or after the date of the agreement and the agreement must specify the tax years for which the agreement applies.

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- (8) The Secretary may cancel an advanced pricing agreement with a taxpayer by notice in writing if the following applies:
- (a) the taxpayer has failed to materially comply with a fundamental term of the agreement;
 - (b) there has been a material breach of one or more of the critical assumptions underlying the agreement;
 - (c) there is a change in the tax law that is materially relevant to the agreement;
 - (d) the agreement was entered into based on a misrepresentation, mistake, or omission by the taxpayer.
- (9) Cancellation of an advance pricing agreement under sub-regulation (8) takes effect:
- (a) for a misrepresentation, mistake, or omission wilfully or negligently made, from the date the agreement was entered into;
 - (b) for a material breach of the critical assumptions underlying the agreement, from the date that the material breach occurred; or
 - (c) for any other case, from the date specified by the Secretary in the notice of cancellation not being a date before the date of service of the notice of cancellation.
- (10) The Secretary must treat as confidential any trade secrets or other commercially sensitive information or documentation provided to the Secretary in the course of negotiating an advance pricing agreement.

PART 5 – CORRESPONDING ADJUSTMENTS

13. Corresponding adjustments

- (1) This Regulation applies when:
- (a) an adjustment is made by a competent authority of a country with which Nauru has a double tax treaty (referred to as the “foreign country”) to the taxation of a transaction or transactions of a taxpayer subject to tax in Nauru; and
 - (b) the adjustment results in taxation in the foreign country of amounts of gross revenue or profits that are also taxable in Nauru.
- (2) When this Regulation applies, the Secretary must, upon request by the taxpayer in the approved form, determine whether the adjustment is consistent with the arm’s length principle and, if the Secretary determines that it is consistent, the Secretary must make a corresponding adjustment to the amount of tax charged in Nauru on amounts of gross revenue or profits so as to avoid double taxation.

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- (3) The Secretary must provide an applicant under sub-regulation (2) with notice, in writing, of the decision on the application.
- (4) A request under sub-regulation (2) must be made by the taxpayer within the applicable time period for making such a request for the case to be resolved by way of mutual agreement procedure under the applicable double tax agreement.

SCHEDULE

Regulation 11

TRANSFER PRICING DOCUMENTATION

A taxpayer must maintain the following transfer pricing documentation:

- (1) An overview of the taxpayer's business operations and organisational structure.
- (2) A description of the organisational structure of the multinational group of which the taxpayer is a member (including details of all group members, their legal form, and their shareholding percentages) and the group's operational structure (including a general description of the role that each of the group members carries out with respect to the group's activities, as relevant to the taxpayer's controlled transactions).
- (3) A description of the taxpayer's controlled transactions, including analysis of the comparability factors specified in Regulation 4.
- (4) An explanation of the reason for the transfer pricing method or methods used.
- (5) Comparability analysis, including:
 - (a) a description of the process undertaken to identify comparable uncontrolled transactions;
 - (b) an explanation of the basis for the rejection of any potential internal comparable uncontrolled transactions (if applicable);
 - (c) a description of the comparable uncontrolled transactions;
 - (d) an analysis of comparability of the controlled transaction or transactions and the comparable uncontrolled transactions; and
 - (e) details and explanation of any comparability adjustments made.
- (6) Details of any industry analysis, economic analysis, budgets, or projections relied on.
- (7) Details of any advance pricing agreements or similar arrangements in other countries that are applicable to the controlled transactions.
- (8) A conclusion as to consistency of the conditions of the controlled transactions with the arm's length principle, including details of any adjustment made to ensure consistency.
- (9) Any other information that may have a material impact on the determination of the taxpayer's compliance with the arm's length principle with respect to the controlled transactions.