



## Income Tax (Transfer Pricing) Regulations 2014

**His Excellency, Tom Marsters**

**Queen's Representative**

### Order in Executive Council

At Avarua, Rarotonga this 17<sup>th</sup> day of June 2014

**Present:**

### His Excellency the Queen's Representative in Executive Council

Pursuant to sections 56A and 229 of the Income Tax Act 1997, His Excellency the Queen's Representative, acting on the advice and with the consent of the Executive Council, makes the following regulations—

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Price \$3.00

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**Regulations**

**Part 1**  
**Preliminary**

- 1 Title**  
These regulations are the Income Tax (Transfer Pricing) Regulations 2014.
- 2 Commencement**
- (1) Subject to subclause (2), these regulations come into force on 1 July 2014 and apply to transactions occurring on or after that date.
- (2) Regulation 12 comes into force on 1 July 2019.
- 3 Interpretation**
- (1) In these Regulations, unless the context otherwise requires—
- Act** means the Income Tax Act 1997
- Arm's length principle**, in relation to a controlled transaction, means that the results of the transaction are consistent with the results that would have been realised in a transaction between independent persons dealing under the same or similar conditions
- Comparability factors** means the factors specified in Regulation 4
- 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 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** has the meaning in the Act and includes a **PE person** and **headquarters person** as defined in Regulation 5

**Relative**, in relation to an individual, means—

- (a) an ancestor, a descendant of any of the grandparents, or an adopted child, of the individual:
- (b) an ancestor, a descendant of any of the grandparents, or an adopted child of a spouse of the individual; or
- (c) a spouse of the individual or of any person specified in paragraph (a) or (b)

**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

**Spouse**, in relation to an individual, includes another individual who, although not legally married to the first-mentioned individual, lives with the individual on a genuine domestic basis in a relationship as a couple

**Transaction** means a supply or acquisition of property, services, money, intangibles, or any other asset, and includes an arrangement, understanding, agreement, or mutual practice whether or not legally enforceable or intended to be legally enforceable, and a dealing between a permanent establishment of a person and another part of the person

**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

**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

**Uncontrolled transaction** means a transaction that is not a controlled transaction.

- (2) For the purposes of these Regulations, two persons are associates when—

- (a) one person is a relative of the other, except when the Collector is satisfied that neither person may reasonably be expected to act in accordance with the intentions of the other;
  - (b) one person participates, directly or indirectly, in the management, control, or capital of the other person; or
  - (c) 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 the other 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) Unless the context otherwise requires, any term that is not defined in these Regulations but is defined in the Act has the meaning assigned to it under the Act.

#### 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;
- (b) the functions undertaken, assets used, and risks assumed by the parties to the transaction;
- (c) the contractual terms of the transactions;
- (d) the economic circumstances in which the transactions take place; and
- (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 Collector 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 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 OECD Transfer Pricing Guidelines for Multi-national Enterprises and Tax Administrations approved by the Council of the OECD for publication on 13 July 1995 (C(95)126/FINAL), as supplemented and updated from time to time.
- (2) If there is any inconsistency between the Act (including these Regulations) and the OECD documents referred to in sub-regulation (1), the Act prevails.

**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) resident persons; or
  - (c) a permanent establishment of a non-resident person in the Cook Islands and a non-resident person outside the Cook Islands.
- (2) These Regulations do not apply to a transaction that takes place wholly in the Cook Islands.
- (3) In this Regulation—
- non-resident** means a person who is not a resident person; and
- resident person** means a person resident in the Cook Islands under section 82 of the Act and includes the following—
- (a) a partnership formed in the Cook Islands; and
  - (b) a trust settled or created in the Cook Islands.

**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 9 and 10.
- (2) When a person has entered into a transaction or a series of transactions to which these Regulations apply, the person must determine its income and expenditures resulting from the transaction or transactions in a manner that is consistent with the arm's length principle.
- (3) If a person does not comply with sub-regulation (2), the Collector may make such adjustments as necessary to ensure that the income and expenditures of the person resulting from the transaction or transactions are consistent with the arm's length principle.
- (4) The determination of whether the result of a transaction or series of transactions is consistent with the arm's length principle is 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 in 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; and
  - (d) the degree of comparability between controlled and uncontrolled transactions, including the reliability of adjustments, if any, that may be required to eliminate differences.
- (5) If, having regard to sub-regulation (4), a person has used an appropriate transfer pricing method, the Collector's examination as to whether income and expenditures resulting from the person's transaction or transactions are consistent with the arm's length principle must be based on the transfer pricing method used by the person.
- (6) A person may apply a transfer pricing method other those listed in the definition of "transfer pricing method" in Regulation 3 if the person can establish that—
- (a) none of the listed methods can reasonably be applied to determine whether a 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 to make a transfer pricing adjustment under Regulation 8(2) in relation to a fee charged for the provision of services by a person ("supplier") to an associate ("recipient"), the Collector must have regard to the following—
- (a) whether the service has actually been provided;
  - (b) whether the service provides, or will provide, the recipient with economic or commercial value that will enhance its commercial position;
  - (c) whether the services are services that an independent person in comparable circumstances would be willing to pay for, or would be willing to perform for itself in-house; and
  - (d) whether the fee corresponds to the fee that would have been agreed between independent persons for a comparable service 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; or
- (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 to make a transfer pricing adjustment under Regulation 8(2) in relation to the consideration given for a licence, sale or other transfer of intangible property by a person (referred to as the “transferee”) to an associate (referred to as the “transferor”), the Collector 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; and
- (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 person must record, in writing, sufficient information and analysis to verify that the controlled transactions of the person are consistent with the arm’s length principle.
- (2) The documentation referred to in sub-regulation (1) for transactions undertaken in an income year must be—
  - (a) in English;
  - (b) prepared prior to the due date for filing of the person’s income tax return for that year; and
  - (c) provided to the Collector within five days, upon written request.
- (3) The Collector may, by notice, specify the items of documentation that a person is required to keep for the purposes of this Regulation.
- (4) The record-keeping obligation of a person specified in this Regulation is in addition to any record-keeping obligation applicable to the person under the Act.
- (5) A person who fails to comply with this Regulation is liable for an amount of penal tax not exceeding \$500,000.
- (6) Part XIII of the Act applies to penal tax imposed under sub-regulation (5).

**Part 4**  
**Advanced pricing agreements**

- 12 Advance pricing agreements**
- (1) A person may request that the Collector enter into an advance pricing agreement to establish an appropriate set of criteria for determining whether the person has complied with the arm's length principle for certain future controlled transactions undertaken by the person over a fixed period of time.
  - (2) A request under sub-regulation (1) must be accompanied by—
    - (a) a description of the person's activities, controlled transactions, and the proposed scope and duration of the advanced pricing agreement;
    - (b) a proposal by the person 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 to 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 person wishes to participate in the advanced pricing agreement; and
    - (d) any other information that the Collector may require as specified in a practice note on transfer pricing.
  - (3) The Collector shall consider a request by a person 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 Collector may decide to enter into an advance pricing agreement or to reject the request.
  - (4) If the Collector agrees to enter into an advance pricing agreement with a person, the Collector may accept the person's proposal under sub-regulation (2)(b), reject it, or modify it with the person's consent.
  - (5) The Collector may enter into an advance pricing agreement with the person either alone or together with the competent authorities of the country or countries identified under sub-regulation (2)(c).
  - (6) If the Collector approves a proposal under sub-regulation (2)(b) or modifies it with the person's consent, the Collector shall enter into an advance pricing agreement that will provide confirmation to the person that no transfer pricing adjustment will be made under Regulation 8(2) to controlled transactions covered by the agreement provided the transactions are 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 income years for which the agreement applies.
  - (8) The Collector may cancel an advanced pricing agreement with a person by notice in writing if any of the following applies—



- (a) the person 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; or
  - (d) the agreement was entered into based on a misrepresentation, mistake or omission by the person.
- (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 Collector in the notice of cancellation not being a date before the date of the notice of cancellation.
- (10) The Collector must treat as confidential any trade secrets or other commercially sensitive information or documentation provided to the Collector in the course of negotiating an advance pricing agreement.

## **Part 5**

### **Corresponding adjustments**

#### **13 Corresponding adjustments**

- (1) When—
- (a) an adjustment is made by a competent authority of a country that the Cook Islands has a double tax treaty (referred to as the “foreign country”) to the taxation of a transaction or transactions of a person subject to tax in the Cook Islands; and
  - (b) the adjustment results in taxation in the foreign country of income or profits that are also taxable in the Cook Islands,
- the Collector must, upon request by the person subject to tax in the Cook Islands, determine whether the adjustment is consistent with the arm’s length principle and, if the Collector determines that it is consistent, the Collector must make a corresponding adjustment to the amount of tax charged in the Cook Islands on the income or profits so as to avoid double taxation.
- (2) The Collector must provide an applicant under sub-regulation (1) with notice, in writing, of the decision on the application.

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Aukino Tairea  
Clerk of the Executive Council

These regulations are administered by the Revenue Management Division of the Ministry of  
Finance and Economic Management.

These regulations were made on the \_\_\_\_\_ day of \_\_\_\_\_ 2014.