Introduction to Transfer Pricing

Transfer Pricing

The transfer pricing rules are found in section 36 a-d of the Income Tax Act in Greenland.

Transfer pricing refers to the pricing of goods, services or intangible assets that are transferred between associated parties.

When trading between independent parties, a seller has a natural interest in selling at the highest possible price, whereas a buyer has a natural interest in buying at the lowest possible price. This means that the trade is carried out on market terms. When trading between associated parties, there is no certainty of concrete, conflicting interests and thus the normal market mechanism may be neutralized.

Transfer pricing is an important area of focus because it affects both a company's tax liability and ability to operate efficiently across borders. Incorrect pricing can result in tax issues, including tax litigation, penalties and interest.

The arm's length principle

The arm's length principle gets its name from the term "to keep distance" or "to be at a distance". The term refers to maintaining an appropriate distance or separation between two parties to ensure that their actions are independent and not influenced by personal relationships or interests.

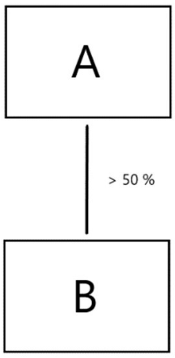
The arm's length principle is mandated in section 36a of the Income Tax Act and requires that, when calculating taxable income, associated parties must use prices and conditions for commercial or economic transactions in accordance with what could have been achieved if the transactions had taken place between independent parties.

Associated parties

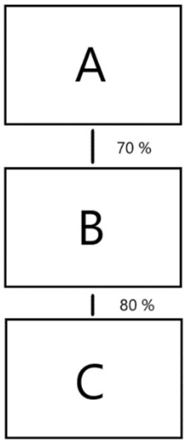
In order for two companies to qualify as related parties, one company must have ownership or voting rights in the other company so that it directly or indirectly owns more than 50 per cent of the share capital or has more than 50 per cent of the votes, cf. section 36 a of the Income Tax Act. The calculation also includes ownership interests or voting rights held by other group companies or associated natural persons. Associated persons include, for example, spouses, parents, grandparents, children, grandchildren, stepchildren and adoptive relationships.

The provision also includes branches of a company. This means that it is not only trade between two companies. There must also be arm's length pricing when a company trades with its branch, regardless of whether the company is located in Greenland and the branch abroad or vice versa. The categorization as an associated party is relevant, as it means that companies are subject to a duty of disclosure to the Tax Agency and thus potentially have to document the nature and extent of trade with associated parties. More on this below.

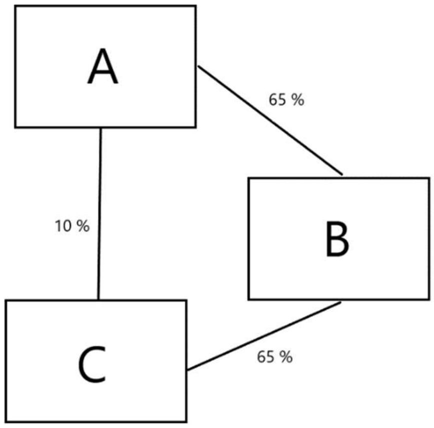
Examples of ownership



Direct ownership



Indirect ownership



Combined direct and indirect

In all three examples, there is a direct or indirect ownership of more than 50%. The companies will therefore be subject to the documentation requirement.

Transfer pricing disclosure and documentation

In connection with its control of transfer pricing, the tax administration needs to obtain information from taxpayers.

In section 36 b of the Income Tax Act, a number of provisions have been introduced which mean that all taxable companies in Greenland must, as a starting point, provide information or be able to document that transactions between associated parties have been made on arm's length terms. This means that the transactions must be documented as having been carried out in the same way as if they had been transactions between independent parties.

This is done through the form S 40, which must be filed together with the tax return. The form deals with the nature and extent of commercial and financial transactions with associated parties with which the taxpayer has been involved during the income year. Examples include intra-group loans or intra-group purchases of goods. The audit information gives the tax administration a better opportunity to seek further clarification of relevant tax matters in an audit situation.

Limited or no documentation requirements

To avoid smaller companies having a disproportionate burden of producing transfer pricing documentation, section 36 b (4) stipulates that companies with fewer than 250 employees and either an annual balance sheet total of DKK 125 million or annual turnover of DKK 250 million are subject to a limited or no documentation requirement.

Smaller companies that have transactions with countries with which Greenland has a double taxation treaty does not need to prepare written documentation.
However, there is a limited documentation requirement for smaller companies that have transactions with related parties:

1) A person or company resident in a country that does not have a double taxation treaty with Greenland.
2) A permanent establishment located in a country that does not have a double taxation treaty with Greenland.
3) A company domiciled in a country that does not have a double taxation treaty with Greenland and where the company has a permanent establishment in Greenland.

Full documentation obligation
The scope of the documentation to be submitted to the Tax Administration pursuant to section 36 b is set out in the Government of Greenland's Executive Order no. 43 of 25 November 2020 on documentation of the pricing of controlled transactions.

The documentation consists of two reports. One report (Master file) is a description of the group, i.e. not only the taxable business in Greenland, but the entire group, which may include many companies, etc. outside Greenland. The second report (Local file) with associated appendices describes the Greenlandic company and the specific transactions that the company has listed in form S 40. In other words, the report describes the steps the company has taken to fulfil the transfer pricing rules, i.e. that a given transaction has been made on arm's length terms.

The company must also prepare a benchmark report that contains data on comparable companies in the same industry. The focal point is a comparison on earnings. The idea is that comparable companies that perform the same **F**unctions, provide similar **A**ssets and bear similar **R**isks in a transaction) should have similar earnings. We call this a **FAR** analysis. For example, if the benchmark report shows that the controlled Greenlandic company has significantly lower earnings than the comparable companies, even though the Greenlandic company has the same functions, makes similar assets available and bears a similar risk, it may indicate that the controlled Greenlandic company incurs more costs or receives a lower remuneration in the trading relationship than would actually occur in a trade between two independent parties. This would mean a lower value for taxation in Greenland and a correspondingly higher value for taxation abroad.

New rules for the income year 2023
Up to and including the income year 2022, companies subject to the documentation obligation have had to present transfer pricing documentation upon request from the Tax Administration.

From the income year 2023, it is mandatory for companies that are subject to full documentation requirements to submit transfer pricing documentation to the Tax Administration. This must be done no later than 60 days after the deadline for submitting the tax return. This is stated in the new section 36 b, which was adopted with Greenland Parliament Act no. 30 of 25 November 2022, See also Executive Order no. 54 of 17 October 2023 on the obligation of certain taxpayers to submit transfer pricing documentation on an ongoing basis.

For further information on transfer pricing, the application of the arm's length principle or the provision of transfer pricing documentation, please contact the Tax Agency or read more at OECD.org, which provides access to comprehensive guidelines.