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Transfer Pricing
Recent Trends and Developments at OECD Level

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Recent Developments:

1. Attribution of profits to Permanent Establishments
2. Revision of Chapters I-III of the Transfer Pricing Guidelines (comparability and profit methods)
3. Transfer Pricing Aspects of Business Restructurings

What does the future hold?

1. ATTRIBUTION OF PROFITS TO PERMANENT ESTABLISHMENTS

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- In July 2008, the OECD Council approved the final Report on the Attribution of Profits to Permanent Establishments
- Partly incorporated in the 2008 update of the OECD Model Tax Convention
- Full implementation in future treaties:
  - New Article 7 and its Commentary to be included in the 2010 update of the MTC (discussion draft released for public comment in November 2009)

2. PROPOSED REVISION OF CHAPTERS I-III OF THE TRANSFER PRICING GUIDELINES

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Proposed revision of Chapter II – Part I

Selection of a transfer pricing method:

- Removes exceptionality of profit methods and replaces it with a standard whereby the selected transfer pricing method should be the "*most appropriate method to the circumstances of the case*".

- Determined by
  - Appropriateness to the nature of the transaction / functional analysis
  - Availability / reliability of comparables

Proposed Revision of Chapter II – Parts II and III

- ***Existing Chapter II: Traditional transaction methods (CUP, Cost Plus, Resale Price): unchanged***

- ***Existing Chapter III: Transactional Profit Methods (TNMM and Profit Split):***
  - Further guidance on practical application
  - TNMM: selection and determination of the net profit margin indicator
  - Profit Split: determination of profit to be split and of splitting factors

Proposed New Chapter III

Comparability Analysis:

- *Objective*: find the most reliable comparables
- No requirement for an exhaustive search of all possible sources of comparables
- Acknowledge limitations in availability of information and compliance costs
- "*Reasonably reliable comparables*": defined as the most reliable comparables in the circumstances of the case, keeping in mind the above limitations
- Typical 10-step process to be followed to perform a

Foreign comparables

- Non-domestic comparables should not be automatically rejected

Secret comparables

- Use of secret comparables discouraged
- Exception: in Mutual Agreement Procedures do eliminate double taxation

Arm's length range and statistical tools

- In some cases it will be possible to arrive at a single figure (e.g. price or margin)
- In most cases: arm's length range
- Eliminate uncontrolled transactions ("potential comparables") with a lesser degree of comparability than others

Arm's length range and statistical tools

- If comparability defects remain that cannot be identified and/or quantified, and are therefore not adjusted use of statistical tools that take account of <u>central tendency</u> might help to enhance the reliability of the analysis

Loss-making comparables

- Not systematically rejected
- Case-by-case (risk profile in particular)
- Independent enterprise would not continue loss-making activities unless reasonable expectation of future profits
- Independent enterprise would not remain loss-making indefinitely.
  - Where an associated enterprise remains loss-making over several years: is it providing a service to the group by maintaining a commercial presence?

3 New Annexes

- Practical illustration of issues in relation to the application of transactional profit methods
- Example of working capital adjustments to improve comparability

3. TRANSFER PRICING ASPECTS OF BUSINESS RESTRUCTURINGS

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Relevance of the issue:

- Tax base erosion concern for certain countries
- Uncoordinated reactions by governments, for instance:
  - Characterise a PE of foreign principal
  - Assess exit / capital gain tax upon conversion
  - Challenge post conversion transfer pricing
  - Attempt to disregard some transactions involved in the restructuring
  - Combine several of the above arguments
- Huge stakes (potential double taxation!) and uncertainties for business
- Lack of consensus

Transfer Pricing Aspects of Business Restructuring

- Definition of business restructurings:

  "Cross-border redeployment (transfer) by a multinational enterprise of functions, assets and/or risks with associated profit/loss potential"

- Focus: How does the arm's length principle and TP Guidelines apply to business restructurings?

Transfer Pricing Aspects of Business Restructuring

- OECD Discussion Draft consists of 4 Issues Notes:

  1. Special Consideration for Risks
  2. Arm's Length Compensation for the Restructuring Itself
  3. Remuneration of Post-Restructuring Controlled Transactions
  4. Recognition of the Actual Transactions Undertaken

The consultation process

- 37 detailed contributions received from the public (see ww.oecd.org/ctp/tp/br)
- Consultation with commentators held 9-10 June 2009

Some good progress !

1. More consensus than non-consensus
2. Starting point is <u>not</u> abusive cases
3. Multinational Enterprises free to organise their business; tax administrations draw tax consequences on the basis of existing rules
4. Same Arm’s Length Principle of Business Restructuring and post-Business Restructuring as for others
5. Absence of comparables does not mean non-Arm’s Length

Some good progress !

6. Profit potential not an asset: decrease of Profit Potential not a taxable event *per se*
7. Article 9 starts from contracts (respected only if actual behaviour conforms with contract + Arm's Length)
8. Examine rights and other assets
9. Look at perspectives of both parties
10. Non-recognition of transactions exceptional: pricing solutions preferred

Way forward

- Business comments identified areas for further work (while generally recognising that OECD draft was balanced)
- WP6 meetings of March 2010 and June 2010.
- Objective = Finalise 2nd half of 2010
- Also to be kept in context: OECD work on dispute resolution (revised Commentary on Art.25; new paragraph on mandatory arbitration; online manual for Mutual Agreement Procedures MEMAP)

Way forward

- WP6 meetings of March 2010 and June 2010.
- Objective to finalise 2nd half of 2010

4. NEXT TOPIC FOR CONSIDERATION (2011-2012): INTANGIBLES?

Transfer Pricing Apects of Intangibles

- Current guidance: Chapters VI and VIII of the TP Guidelines

- Emerging issues:
  - Definition ("soft intangibles"): marketing intangibles, workforce in place, business opportunities, etc: Are they intangibles? More importantly, should they be compensated at arm's length?
  - Legal / economic ownership; right to share in the return of an intangible that is owned by another party
  - Valuation methods

Thank you very much for your attention!

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