Insights:
Transfer Pricing

Charles River Associates

OECD releases two key transfer pricing documents

On the heels of the Base Erosion and Profit Sharing (BEPS) Action Plan, which the Organisation for Economic Cooperation and Development (OECD) released on July 19[1], the OECD released two transfer pricing documents on July 30 that represent important contributions to some of the BEPS actions:

- a "Revised Discussion Draft on Transfer Pricing Aspects of Intangibles"[2]; and
- a "White Paper on Transfer Pricing Documentation"[3].

Revised Discussion Draft on Transfer Pricing Aspects of Intangibles

The OECD's revised draft on intangibles follows the comments received and subsequent public consultation on the initial discussion draft published in June 2012.

This work is now an integral part of action #8 in the BEPS Action Plan. As the revised draft makes clear, it is also closely related to some of the other BEPS actions, including the work on allocation of risks and capital, re-characterization of transactions, hard to value intangibles, and transfer pricing methods, including profit splits. The OECD notes that the revised draft should be considered a work in progress and that portions of it may be revised during the course of the BEPS work.

Many changes from the 2012 discussion draft are apparent in the new document and some sections have been reorganized. The revised draft begins with a new section that specifically addresses local market features, location savings, assembled workforce, and corporate synergies. The revised draft also contains a new section on dealing with corporate names and includes new examples in the Annex.

Notably, certain key aspects have not fundamentally changed, in particular the positions adopted in relation to the definition of intangibles and how to determine the parties entitled to intangible-related returns:

[1] http://www.crai.com/uploadedFiles/Publications/TP-Insights-OECD-releases-BEPS-Action-Plan.pdf

[2] http://www.oecd.org/tax/transfer-pricing/intangibles-discussion-draft.htm

[3] http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-documentation.htm

- Although the document now acknowledges that "difficulties can arise in a transfer pricing analysis as a result of definitions of the term intangible that are either too narrow or too broad," the broad intangible definition remains, i.e. something which is not a physical asset or a financial asset, and which is capable of being owned or controlled for use in commercial activities.
- The revised draft also does not fundamentally change the principle from the first draft that neither legal ownership, nor the bearing of costs related to intangible development, taken separately or together, entitles an entity within a multinational group to retain the benefits or returns with respect to intangibles, "without more." Indeed, these concepts are developed further in the revised draft:
  - In relation to the role of legal ownership in determining ownership for transfer pricing purposes, the revised draft states very clearly that "the question of legal ownership is separate from the question of remuneration under the arm's-length principle" and that "the return ultimately retained by the legal owner depends upon the contributions it makes to the anticipated value of the intangibles through its functions performed, assets used, and risks assumed, and upon the contributions to the anticipated value of intangibles made by other MNE group members."
  - Notably, the revised draft also strengthens the link between carrying out "important functions" related to the development, enhancement, maintenance and protection of intangibles, and the entitlement to intangible related returns. In particular, it notes that:
    - An entity claiming the right to retain "all or material parts of" the related return on the basis of legal ownership will generally perform the more important functions through its own employees.
    - If important functions are outsourced, because it may be difficult to find comparable transactions, it may be necessary to use transfer pricing methods that are not directly based on comparables "including profit split methods and valuation techniques."
    - Where the legal owner outsources most or all of the important functions to other group members, its entitlement to "any material portion of the return" after compensating other group members for their functions is "highly doubtful." It then goes on to state that it may be determined that such outsourcing would not have been undertaken by independent enterprises behaving in a commercially rational manner "thereby necessitating the disregarding of the actual structure."
    - In relation to the funding of intangibles in isolation, bearing a funding risk, without the assumption of any further risk, and without any control over the use of the contributed funds or the conduct of the funded activity, generally would entitle the funder to a risk-adjusted rate of anticipated return on its capital invested, but not more.

White Paper on Transfer Pricing Documentation

The White Paper on documentation is a product of the OECD's transfer pricing simplification project, which is now also effectively incorporated in the BEPS work (action #13). The White Paper includes the results of a survey of transfer pricing documentation requirements and practices around the world and considers the general purposes and objectives of transfer pricing documentation.

The White Paper suggests how local rules relating to documentation might be modified to make compliance simpler and more straightforward for taxpayers, while providing tax authorities with more focused and useful information to make transfer pricing risk assessments. In particular, it notes that more information is often needed on the "big picture" than is typically available in country-focused documentation.

Following the EU Transfer Pricing Documentation format, the White Paper proposes a two-tiered master file/local file structure and lists the potential content for these documents. It notes that the OECD believes that this "offers a balanced trade-off between greater transparency requested from [Multinational Enterprise] and more streamlined country transfer pricing documentation requirements."

The OECD invites interested parties to send comments on both documents by October 1, 2013.

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