Insights: Transfer Pricing

CRA Charles River Associates

OECD releases BEPS Action Plan

On July 19, the Organisation for Economic Cooperation and Development (OECD) released its Action Plan to address Base Erosion and Profit Shifting (BEPS) by multinationals.

The G20 had requested an update on the OECD's progress on its BEPS project in November 2012, spurred by France, Germany, and the UK. The OECD duly published a brief report in February of this year announcing the development of the plan and outlining the "pressure areas" it would focus on, including transfer pricing.

The Action Plan follows through on the ambitions of the February report and identifies 15 actions that the OECD considers necessary to address BEPS and to provide "countries with domestic and international instruments that will better align rights to tax with economic activity." It sets deadlines for the delivery of the "expected output" from each action, ranging from 12 to 24 months.

The Plan includes a number of transfer pricing-specific actions and other actions that have a strong link to transfer pricing. Many of the actions are connected and the work will be coordinated.

The outputs from the actions are expected to include recommendations regarding domestic law provisions, changes to the Commentary to the OECD Model Tax Convention and to the Convention itself, and also to the Transfer Pricing Guidelines.

The 15 actions are summarized below; anticipated changes to the Transfer Pricing Guidelines are underlined. The deadlines are indicated in brackets.

1. **Address the tax challenges of the digital economy** – issues to be examined include the ability of a company to have a significant digital presence without being liable to taxation under current rules and how to attribute the value created from the generation of "marketable location relevant data." It is noted that the work will require a thorough analysis of the various business models in the sector and will consider both direct and indirect taxation. A report identifying the issues and possible actions to address them will be prepared.[1] [September 2014]

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[1] A report published by the French Government at the beginning of 2013 could influence the work on this topic. See also: Alberto Pluviano, "**The French Government Report on Taxation of the Digital Economy**", *Diritto e Pratica Tributaria Internazionale*, April 2013.

2. **Neutralize the effects of hybrid mismatch arrangements**, i.e. hybrid instruments and entities that enable, for example, double non-taxation through mismatches between domestic rules. [September 2014]

3. **Strengthen Controlled Foreign Corporation (CFC) rules** – recommendations to strengthen the design of CFC rules will be developed. [September 2015]

4. **Limit base erosion via interest deductions and other financial payments** – recommendations will be developed regarding best practices in the design of rules to prevent, for example, the use of related-party and third-party debt to achieve excessive interest deductions. The work will evaluate the effectiveness of different types of limitations. Transfer pricing guidance will also be developed for financial transactions, including financial and performance guarantees, derivatives, and captive and other insurance arrangements. [September 2015]

5. **Counter harmful tax practices more effectively, taking into account transparency and substance** – the OECD will revamp its existing work on harmful tax practices that encourages countries to remove tax breaks and preferential regimes. This will include developing a strategy to expand participation to non-OECD members. [September 2014 and December 2015]

6. **Prevent treaty abuse** – recommendations and model treaty provisions will be developed in relation to the design of domestic rules to prevent treaty benefits from being granted in inappropriate circumstances (i.e. treaty shopping), for example where double non-taxation is generated. [September 2014]

7. **Prevent the artificial avoidance of Permanent Establishment** (**PE) status** – changes to the PE definition will be developed to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. This work will also address related profit attribution issues. [September 2015]

8. **Assure that transfer pricing outcomes are in line with value creation: intangibles** – rules will be developed to prevent BEPS by moving intangibles among group members. These will involve:

   - adopting a broad and clearly delineated definition of intangibles [September 2014];
   - ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation [September 2014];
   - developing transfer pricing rules or special measures for transfers of hard-to-value intangibles [September 2015]; and
   - updating the guidance on cost contribution arrangements. [September 2015]

9. **Assure that transfer pricing outcomes are in line with value creation: risks and capital** – rules will be developed to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be coordinated with the work on interest expense deductions and other financial payments. [September 2015]

10. **Assure that transfer pricing outcomes are in line with value creation: other high-risk transactions** – rules will be developed to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to:

- clarify the circumstances in which transactions can be re-characterized;
- clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and
- provide protection against common types of base eroding payments, such as management fees and head office expenses. [September 2015]

11. **Establish methodologies to collect and analyze data on BEPS and the actions to address it** – recommendations will be developed regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness of the actions taken. [September 2015]

12. **Require taxpayers to disclose their aggressive tax planning arrangements** – recommendations will be developed regarding the design of mandatory disclosure rules for aggressive or abusive transactions, etc. [September 2015]

13. **Re-examine transfer pricing documentation** – rules will be developed regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that multinational enterprises (MNEs) provide all relevant governments with needed information on their global allocation of the income, economic activity, and taxes paid among countries according to a common template. [September 2014]

14. **Make dispute resolution mechanisms more effective** – solutions will be developed to address obstacles that prevent countries from solving treaty-related disputes under the Mutual Agreement Procedure (MAP), including the absence of arbitration provisions in most treaties. [September 2015]

15. **Develop a multilateral instrument** – the tax and public international law issues related to the development of a multilateral instrument will be analyzed to enable jurisdictions to implement measures developed through the BEPS work and amend bilateral tax treaties. [September 2014 & December 2015]

The OECD has sought to involve all relevant stakeholders in the Action Plan. In particular, it proposes that interested G20 countries that are not members of the OECD should be invited to be part of the project as associates, i.e. on an equal footing with OECD members. Other non-member countries could be invited to participate on an ad hoc basis.

The Action Plan also stresses the importance of consultation with non-governmental stakeholders, noting that the OECD's core relationship with civil society is through the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) to the OECD.

Charles River Associates (CRA) is an active member of the BIAC Tax Committee and participated in the International Business Dialogue on BEPS that BIAC organized on March 26, 2013 which included representatives from governments and the OECD Secretariat. BIAC is now organizing a consultation meeting on the BEPS Action Plan with the OECD, to be held on October 1, 2013 in Paris, in which CRA will also participate.

The Action Plan is clearly ambitious in scope and timing and some actions will be easier to implement than others, yet there is broad political support for at least some change to the international tax system. The OECD has already followed through on some of the actions with the release on July 30 of two important transfer pricing documents, on intangibles and documentation.[2]

Most multinationals should expect their tax and transfer pricing policies to be affected in some way by the results of the work and so the continuing engagement of the business community is critical.

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[2] **http://www.crai.com/uploadedFiles/Publications/TP-Insights-OECD-releases-two-key-transfer-pricing-documents.pdf**