



Insights: Transfer Pricing

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OECD public consultation on transfer pricing topics

The Organisation for Economic Co-operation and Development (OECD) held a two-day public consultation on transfer pricing matters on November 12 and 13 in Paris to discuss:

- the Revised Discussion Draft on Transfer Pricing Aspects of Intangibles;
- the requirement by the Action Plan on Base Erosion and Profit Shifting (BEPS) to adopt a system of country-by-country reporting;
- the White Paper on Transfer Pricing Documentation; and
- other transfer pricing aspects of the BEPS Action Plan.

Delegates from more than 35 governments and 150 representatives of business, academia, civil society, and the press, attended the meeting which was broadcast live over the Internet. A number of meeting summaries have been published.¹ In this article, we focus on the key discussions and provide practical suggestions on how multinational enterprises (MNEs) can prepare for the changes the BEPS and intangibles projects will bring and what matters will likely require more urgent attention.

As the OECD is working on these topics under mandate from the G20 and within the framework of the BEPS Action Plan, precise and relatively short deadlines have been established to complete the technical work and reach consensus among the participating countries. Specifically, the OECD project on the Transfer Pricing Aspects of Intangibles, which started in 2010 as a standard OECD project and was progressing within an appropriate time frame given its complexity and controversial aspects, now has a set deadline of September 2014.

Intangibles

The more significant or common practical challenges are:

- ownership of intangibles and allocation of an “intangible related return”;
- intangibles transferred in combination with services;
- transfer pricing methods for intangibles; and

¹ Including, for example, the *TP Week* transcript of closing remarks by The Business and Industry Advisory Committee to the OECD. Accessed January 2, 2014, <http://www.tpweek.com/Article/3278736/BIAC-addresses-OECD-with-closing-remarks-on-transfer-pricing-consultation.html>.

- marketing intangibles.

Ownership of intangibles and allocation of an intangible related return

The Revised Discussion Draft² states that legal ownership is only the starting point to allocate the return attributable to an intangible and such allocation should be based on functions performed, assets used or contributed, and risks assumed. The draft also states, at paragraph 73, that “where the legal owner makes no contributions that are anticipated to enhance the value of the intangible, the legal owner will not ultimately be entitled to retain any portion of the return attributable to the intangible.” During the meeting, business representatives highlighted the fact that in outsourcing contracts between independent parties, the legal owner quite often delegates most of the control functions to the supplier. On this point, some participants observed that an **intangible related return** (IRR) approach, overruling the evidence provided by comparables, appears to contradict the arm’s length principle and may even risk rejection by courts. Even among the country delegates, IRR remains controversial and it is therefore difficult to say whether the current draft will change and, if so, how significantly. Some business representatives also highlighted that Chapter IX of the OECD Transfer Pricing Guidelines, added to the Guidelines in 2010, thoroughly addresses the subject of attribution of risk. It is not clear whether or not the views expressed now contradict the principles laid down in Chapter IX.

In practice, MNEs should expect that the future guidelines will put more emphasis on functions performed and that one-sided transfer pricing methods will be viewed more suspiciously if they are perceived to artificially allocate profits to low tax jurisdictions.

Intangibles transferred in combination with services

The concept underlying the transfer of intangibles in combination with services is expressed in paragraph 150 of the revised discussion draft: “... the performance of a service using intangibles may have very similar economic consequences to a transaction involving the transfer of an intangible (or the transfer of rights in the intangible), as either may convey the value of the intangible to the transferee.”

Various representatives from the business community highlighted the risk that audit inquiries, trying to identify transfers of intangibles within services transactions, would generate a high level of uncertainty and enormous difficulties (especially for large organizations) managing intercompany services. Some business representatives also observed that these cases should be looked at as separate transactions, i.e. an intercompany service transaction and the transfer of an intangible.

Unfortunately, it is unlikely the OECD will withdraw this concept because country delegates may consider it a tool to fight abusive situations (for example, transfer of valuable know-how or trade secrets as part of a service transaction priced only as a service, i.e. without taking into account the value of transferred intangibles). While it is understandable that the OECD highlights this potential issue, experience shows that audits in these instances may become quite aggressive and could lead to burdensome inquiries and controversy.

² “Revised Discussion Draft on the Transfer Pricing Aspects of Intangibles,” OECD, July 30, 2013. Accessed January 2, 2014, <http://www.oecd.org/ctp/transfer-pricing/revised-discussion-draft-intangibles.pdf>.

The best way to address these concerns may be to develop and document internal guidelines, categorize expenses, and refer as much as possible to comparability standards to identify services that (although exploiting certain intangibles) at arm's length would be priced as simple services rather than transfers of intangibles.

Transfer pricing methods for intangibles

The discussion about transfer pricing methods for intangibles was difficult given the participants' awareness of political concerns and the "public" nature of the discussion. For example, some non-governmental organization (NGO) representatives spoke favorably of profit split, but didn't appear to reference the method currently described in the OECD Guidelines, but rather an ideal method allowing taxable profit to be shared "fairly" among the jurisdictions in which a multinational group operates. On the other hand, some business delegates highlighted that, although not perfect, comparables often exist, and that it is often possible to make reliable comparability adjustments. Despite a general feeling that profit split will be more commonly used in the future for intangibles, there was limited discussion about the practical issues. The use of comparables was debated at length, and remains controversial. Valuation techniques were also discussed and whether the revised Guidelines should provide more or less detailed guidance than the current draft remains an open issue.

Whatever shape the final version takes, we anticipate more stringent conditions for comparables to be considered acceptable and the more frequent use of valuation methods to define intangibles' values.

Marketing intangibles

The discussion of marketing intangibles was relatively limited and inconclusive. The OECD Secretariat was interested to hear whether the categorization of marketing intangibles in the draft was considered helpful. This may have been a missed opportunity to clarify the implications of new or updated wording in the Revised Discussion Draft that could significantly affect the approach to the reward of distribution functions, considering a growing number of cases where countries hosting distribution subsidiaries assert the existence of local marketing intangibles.

In practice, companies should consider the implications for distribution activities, in the likely event that most of the current draft wording will be finalized without major changes this year. The challenges for distribution subsidiaries may happen quickly in various countries.

The Revised Discussion Draft on Transfer Pricing Aspects of Intangibles includes six new or edited topics that should be individually addressed and considered as they interact with each other:

- Marketing intangible definition
- Location savings
- Other local market features
- Development and enhancement of marketing intangibles
- Payments for use of the company name
- The six examples illustrating the application of Section B principles in the context of marketing and distribution arrangements.

Country by country reporting

Country by country reporting (CBCR) remains an open subject. While there is general consensus on the fact that CBCR will be implemented, the OECD white paper published on July 30, 2013 mainly listed the fundamental questions about how to design the reporting. The positions at the OECD public consultation were too different to show any clear direction. They ranged from NGOs asking for a solution that will be accessible to the public (highlighting the pressure for CBCR and the fact that uncontrolled news is published anyway today), to the OECD Secretariat reminding that the BEPS mandate requires a reporting mechanism for tax authorities only. Some business representatives highlighted the confidentiality issues and others proposed a solution under which CBCR should only be filed centrally with the tax authorities of the headquarter's country and information exchanged between tax authorities exclusively via treaty network. The discussion about the content of CBCR remained relatively limited and high level. This project appears to be particularly difficult and apparently the OECD Secretariat is devoting significant efforts to understand the practicalities of this issue.

The most reasonable approach for companies at this stage would be to identify the team that will deal with this issue and monitor developments.

Transfer pricing documentation

There was a general consensus that a master-file/country-file approach is helpful. The OECD Secretariat seemed interested in testing the importance of having a standardized and unified approach, rather than leaving this subject to individual country regulations. Various business representatives emphasized the usefulness of standardization and several practical issues like materiality thresholds, translation, country benchmark requirements, and accounting standards.

Similarly to CBCR, the discussion about the practical content of documentation was relatively limited. In contrast, the White Paper on Transfer Pricing Documentation published on July 30, 2013³ contains a detailed structure of documentation, so it is possible that the proposed structure will be largely kept in a final version. If this is the case, the "risk-assessment" dimension of documentation will be significantly emphasized and a more qualitative (but also quantitative) set of information will be required on subjects like business profit drivers, intangibles, supply chain details, intercompany services, business restructuring, intercompany financial activities, group APAs and rulings, number of employees by country, and geographical location of senior executives.

Companies will need to wait to see how the OECD formalizes the final document and how this will affect individual country regulations. It is important to start assessing the practical implications of providing this type of qualitative information, as some tax authorities could rapidly adopt the requirements of the OECD draft within their standard questions during tax audits, or directly update their local country formal documentation requirements.

³ "Public Consultation, White Paper on Transfer Pricing Documentation," OECD, July 30, 2013. Accessed January 2, 2014, <http://www.oecd.org/ctp/transfer-pricing/white-paper-transfer-pricing-documentation.pdf>.

Conclusion

Many companies have adopted a “wait-and-see” approach as the OECD Guidelines update is typically a lengthy process. While it may still be appropriate to wait for developments on certain topics, it is important to understand that the climate has completely changed and a negative image of multinationals allegedly not playing fairly in international taxation is spreading across important sectors of our society (political, governmental, public opinion, and media).

At the OECD public consultation, some NGO representatives expressed frustration about detailed technical discussion perceived as inappropriate to address the challenge of eliminating unfair behaviors of MNEs. There is likely much more good will among the business community than is perceived and those demonstrating unfair behaviors do not usually join OECD consultations. However, public opinion should be taken into account and MNEs need to consider their reputations and how to communicate their strategy on tax matters.

Overall, a “risk assessment” approach is suggested, focused on identifying potential exposures, including the risk of publicity that may negatively affect the company image.

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