



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 central tendency 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 www.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 not 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

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- Objective to finalise 2nd half of 2010



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



Transfer Pricing Aspects 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



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your attention!*

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