Global Transfer Pricing

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OECD Releases Five Transfer Pricing Discussion Drafts

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As expected, the Organization for Economic Cooperation and Development issued five public discussion drafts on transfer pricing topics during the week of December 15-19. Deloitte's Global Transfer Pricing group is preparing detailed analyses of the drafts, which will be distributed in a special edition of *The Arm's Length Standard* in early January 2015.

The first two discussion drafts – on **the transfer pricing aspects of cross-border commodity transactions** and on **the use of profit splits in the context of global value chains** – were issued December 16 under Action 10 of the BEPS Action Plan, which calls for work to be undertaken to develop "rules 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 measure to . . . (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains, and (iii) provide protection against common types of base eroding payments."

The discussion draft on commodity transactions addresses problems reported by countries where the commodities sector provides the major source of economic activity, including difficulties in determining adjustments made to quoted prices, verifying the pricing date, and accounting for the involvement of other parties in the supply chain.

In response, the discussion draft proposes a two-pronged approach:

- Additional guidance in Chapter II of the Transfer Pricing Guidelines clarifying that (i) the comparable uncontrolled price method can be an appropriate transfer pricing method for commodity transactions between associated enterprises; and (ii) that quoted or publicly available prices can be used under the CUP method as a reference to determine the arm's length price for the controlled commodity transaction.
- Additional guidance on Chapter II of the transfer pricing guidelines regarding the adoption of a deemed pricing date for commodity transactions between associated enterprises in the absence of evidence of the actual pricing date agreed by the parties to the transactions.

The second OECD release, on the use of profit splits in the context of global value chains, examines eight scenarios in which it may be more difficult to apply one-sided transfer pricing methods to determine transfer pricing outcomes that are in line with value creation, and in which the application of a transactional profit split method may be appropriate. These scenarios provide the context for the OECD to pose questions on the application of the transactional profit split method. The responses to those questions will inform the OECD's revisions to the guidance on the use of the transactional profit split method in Chapter II of the transfer pricing guidelines.

The third discussion draft, issued December 18 pursuant to Action 14 **(make dispute resolution mechanisms more effective**) of the BEPS Action Plan, adopts four organizing principles:

- Ensuring that treaty obligations related to the mutual agreement procedure are fully implemented in good faith;
- Ensuring that administrative processes promote the prevention and resolution of treaty-related disputes;
- Ensuring that taxpayers can access the mutual agreement procedure when eligible; and
- Ensuring that cases are resolved once they are in the mutual agreement procedure.

The draft then identifies 22 obstacles to the resolution of treaty-related disputes through the mutual agreement procedure (MAP) mechanism, and presents 34 options to address those obstacles.

The fourth discussion draft, also issued on December 18, is at 93 pages the longest of the drafts. The draft, issued under Action 4 of the BEPS Action Plan, which calls for limiting base erosion via interest deductions and other financial payments, is a consultation document that seeks input on key issues concerning the design of rules to address base erosion and profit shifting using **interest and similar financial payments**. Some of the options discussed include general interest limitation rules that set out an overall limit on the amount of interest expense in an entity, by linking interest deductibility to the position of a group or to fixed ratios, as well as targeted interest limitation rules that address specific base erosion and profit shifting risks.

The final **discussion draft on risk, recharacterization, and special measures** – and the last one to be issued in 2014 – tackles issues raised under Actions 8, 9, and 10 of the BEPS Action Plan, whose general aim is to ensure that transfer pricing outcomes are in line with value creation, and more specifically call for the development of rules to prevent base erosion and profit shifting by transferring risks among group entities, to clarify the circumstances under which transactions could be recharacterized, and rules or special measure for transfers of hard-to-value intangibles.

The discussion draft includes a proposed revision to Section D of Chapter I of the transfer pricing guidelines emphasizing the importance of accurately delineating the actual transactions, and includes guidance on the relevance and allocation of risk. The draft also sets out options for some special measures, but stresses that those proposed measure have been only broadly outlined, and that significant design work would still be needed as the measures are further considered.

The OECD has invited interested parties to submit comments on the discussion drafts by February 6, 2015, with the exception of comments on the dispute resolution discussion draft, which are due on January 16.

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