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Transfer pricing alert

Changes to transfer pricing Guidelines

July 31, 2015

On July 7, 2015, the Organization for Economic Co-operation and Development (OECD) provided a full status update on the transfer pricing developments in relation to its work on base erosion and profit shifting (BEPS). The purpose of the update was to aid businesses in understanding the process for finalizing the OECD's BEPS work and to provide information on key areas where the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Guidelines) are expected to change.

The OECD has provided a useful framework of the proposed changes to date by presenting the BEPS actions in the context of changes to the chapters of the OECD Guidelines, as summarized below. While not all changes have been agreed to in all respects, most are not expected to change significantly upon final approval.

OECD effort to culminate in new global guidance

Chapter I of the Guidelines will be updated to take account of the need to delineate the actual transaction undertaken, risk and recognition of the accurately delineated transaction (from the OECD's 2015 work) and locational advantages, workforce in place and synergistic benefits (from the OECD's 2014 work).

Delineating the actual transaction involves reflecting on the conduct of the parties in order to deduce, clarify or supplement the contractual terms between related parties. The new guidance places emphasis on conduct and reduces relative reliance on contracts between related parties, though written contracts will always be important as a starting point to the transfer pricing analysis.

Clarity will also be provided on the relationship between the contractual arrangements and the conduct (activities) of the parties. Contractual arrangements form the starting point of the transfer pricing analysis, and understanding the conduct is relevant to assessing whether there are contradictions between the contractual arrangements and the parties' conduct. This clarity will fill in gaps in the contractual arrangements and aid in interpreting the contracts for pricing purposes.

Chapter II of the Guidelines will be updated in relation to commodity transactions. (This update was recently been approved by Working Party 6.) The update will include consideration of the use of commodity prices under the comparable uncontrolled price method, allowing deeming provisions for the pricing date, and providing for access to tax treaty mutual agreement procedures.

Chapter V of the Guidelines will be updated for transfer pricing documentation requirements (including country-by-country reporting). This will incorporate three OECD releases: the September 2014 report[1], the February 2015 implementation guidance on country-by-country reporting[2] and the June 2015 implementation package[3].

Chapter VI of the Guidelines will be updated in relation to intangibles, including the 2014 work emphasizing functions and contributions to value and the current work on hard-to-value intangibles. It is anticipated that fundamental changes are not needed to the 2014 work on the pricing of intangibles. There will, however, be some changes for consistency with other revisions following the new guidance on risks and recognition of the accurately delineated transaction.

Chapter VII of the Guidelines will be updated in relation to low value-adding services. There is broad agreement to implement a "simplified approach". To address concerns from some developing countries that levels of services might be too high, a full transfer pricing analysis will be permitted if deductions are higher than a set threshold.

Chapter VIII of the Guidelines will be updated in respect of the current work on cost contribution arrangements (CCA), which aligns CCA guidance with other changes to the OECD guidelines. The intent is that outcomes of operating within a CCA should be the same as if the CCA had not existed.

Further work will be undertaken in 2016 in relation to the use of profit splits, transfer pricing of financial transactions, attribution of profits to permanent establishments and implementation of the hard-to-value intangibles proposals.

Canada is likely to quickly adopt and enforce the new Guidelines

Formal adoption of new guidance into domestic transfer pricing rules is likely to vary from country to country, depending on how each country's rules interact with OECD guidance. As an active participant in the OECD's BEPS work impacting transfer pricing, Canada is likely to adopt the new Guidelines swiftly.

Preparing for the new guidance

The best practice for businesses is to take account of the revised guidance as soon as possible. Although some revisions are currently only in draft form, certain themes are prevalent and are unlikely to change. For example, the need to ensure that written contracts are in place and that conduct is consistent with those contracts is something that can be addressed proactively. Similarly, early self-assessment of whether current intellectual property arrangements are likely to withstand scrutiny around key functions, decision making and control of risk is suggested. Of course, as the new documentation guidance has been finalized, steps must be taken now to be ready for implementation.

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[1] *Guidance on Transfer Pricing Documentation and Country-by-Country Reporting*.
[2] *Action 13: Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting.*
[3] *Action 13: Country-by-Country Reporting Implementation Package*.

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