

Contacts:

Kerwin Chung
kechung@deloitte.com

Alan Shapiro
alan.shapiro@tohatsu.co.jp

Boris Nemirov
bnemirov@deloitte.com

Darcy Alamuddin
dalamuddin@deloitte.com

OECD BEPS Transfer Pricing Deliverables on Track for September G20 Review and Approval



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By Kerwin Chung (Washington DC) and Alan Shapiro (Tokyo)

The Organization for Economic Cooperation and Development has made considerable progress on the OECD/G20 base erosion and profit shifting (BEPS) project toward the goal of approval by the G20 in September 2014 of the 2014 BEPS Action Plan deliverables of the two transfer pricing action items.

During the past month, the OECD has held several important events at which progress on the 2014 transfer pricing deliverables was discussed. On May 19, the OECD held a public consultation in Paris on draft changes to the documentation rules in Chapter V of the OECD transfer pricing guidelines; on May 26, the OECD held a webcast to provide updates to the public on the BEPS project, including the 2014 transfer pricing deliverables on intangibles and documentation; and on June 2 and 3 the OECD, together with international business organizations, held its annual International Tax Conference in Washington, D.C. Taxpayers have closely monitored these developments to help plan for the inevitable impact on their transfer pricing policies and tax dispute resolution processes.

Current Status

With respect to the transfer pricing Action Plan items, Marlies de Ruyter, head of the Tax Treaty, Transfer Pricing, and Financial Transactions Division of the OECD's Center for Tax Policy and Administration, stated at the Washington, D.C. conference that Working Party No. 6 has substantially agreed to the revised text of Chapters I, II, V, and VI of the OECD transfer pricing guidelines. However, the OECD has recognized that the work on the 2014 BEPS Action Plan deliverables will be affected by the 2015 Action Plan deliverables and, therefore, certain sections will not be final when they are released to the public later this year.

Although the work of the OECD on BEPS is not complete, increasingly countries are not waiting for the final reports to take unilateral action. Especially with respect to the transfer pricing items, local tax authorities are moving ahead with inquiries focusing on both information and theories they believe are consistent with the direction of the Action Plan items.

Intangibles

De Ruyter did not indicate whether WP6 made any significant changes to the revised discussion draft on transfer pricing aspects of intangibles released to the public in July 2013. However, de Ruyter acknowledged that Actions 8 (transfer pricing aspects of intangibles), 9 (transfer pricing aspects of risk and capital), and 10 (transfer pricing of high-risk transactions) of the BEPS Action Plan will have a

significant impact on Section B of the revised discussion draft, which addresses the criteria for the entitlement to intangible returns. Therefore, this section of the guidelines will not be in final form when the G20 approves the 2014 deliverables in September, so that the OECD can take the transfer pricing Action Plan items deliverable in 2015 into consideration. De Ruiter announced that WP6 will begin “priority” work on these items and expects to publish a discussion draft on those issues in December 2014. De Ruiter stated that this new work will provide guidance on the most challenging BEPS transfer pricing issues. Among the specific issues that will be considered are returns to risk, “excessive” capitalization, low functionality, and mere contractual assumption of risk. De Ruiter said approaches will be developed “either within the arm’s length principle or outside, either by special measures or not by special measures.”

It is unclear whether WP6 has reached complete consensus on the functions that will determine the entitlement to intangible returns. Clearly, it has acknowledged that capital and risk play an important role in determining entitlement to intangible returns. At the OECD’s Washington, D.C. conference, the U.S. representative to WP6 indicated a preference for an upfront analysis similar to the cost sharing “investor model” to determine the returns to capital and risk. It is not clear the extent to which other countries’ representatives share the U.S. representative’s view that such an analysis is appropriate in all cases, in particular cases in which the capital provider is unable to appropriately manage the deployment of its capital.

Speakers at the Washington D.C. conference indicated that the July 2013 revised discussion draft language on location-specific advantages and passive association was unlikely to change. Although these are not considered intangibles, they are likely to have a significant impact on a transfer pricing analysis when applicable.

The full parameters of the OECD’s work on intangibles are unlikely to be known until 2015. However, low-functioning entities that primarily rely on the provision of capital and the assumption of contractual risk to earn intangibles returns may not find support for their position in the final OECD guidance. Tax authorities throughout the world have already gotten the OECD’s message and are increasingly challenging the returns earned by low-functioning entities. Some current international structures may face heightened scrutiny based upon the final OECD guidance. Therefore, it may be worthwhile to review the functions and risks of group entities currently earning intangible returns in light of the OECD direction to be prepared in the event of an examination by tax authorities.

Documentation

De Ruiter announced that WP6 has reached consensus on a new approach to transfer pricing documentation, which will include three levels of documentation:

- a country-by-country (CbC) template that will provide high-level financial and activity information for group members that will be used for risk assessment;
- a master file that will provide a big-picture view of the business’s global operations; and
- a local file that will provide a detailed transfer pricing analysis.

WP6 had announced previously that the information to be contained in the CbC template would be reduced from 14 items to eight items in six categories. Unfortunately, WP6 has not released the definition of items that will be required. For example, WP6 has stated that the template will require revenue earned on an aggregate country basis by all enterprises in the country. WP6 has not stated whether the revenue will need to be broken down between third-party revenue and related-party revenue, as had been indicated in some releases. Similarly, WP6 has stated that companies will need to provide aggregated accrued taxes on a country basis. However, WP6 has not stated whether accrued taxes are taxes accrued for financial statement purposes or just accrued but unpaid current taxes. These definitions will have a major impact on the burden on business to collect the data.

On the webcast and at the Washington, D.C. conference, de Ruiter stressed the increased transparency that will result from the three-part disclosure. This

increased transparency will provide local tax examiners, sometimes for the first time, sufficient information to understand the profits and profit drivers of the entire group, de Ruiter said. The increased transparency will enable local examiners to determine whether income is being earned where value is being created. De Ruiter provided an example of a service fee charged to a local enterprise. The CbC template would provide the profit earned by the entity providing the service, the master file would provide information on how the service fee related to the overall business of the enterprise, and the local file would explain how the service fee provided a benefit to the local company.

De Ruiter stated that WP6 recognizes that a structured and careful implementation of the new documentation tools will be key to their success for both governments and businesses. She stated the implementation should result in:

- consistency in governments' adoption of the requirements for all three documentation elements;
- timeliness of relevant information made available to governments;
- confidentiality of commercially sensitive information;
- a balancing of costs for both taxpayers and tax administrations; and
- security that information is used only as intended.

This work will, in part, address whether the CbC template -- and possibly the master file -- will be filed in the home country or locally. In addition, business has expressed concern that the CbC template will result in increased controversy. WP6 will also look at methods to reduce the risk of double taxation. WP6 recognizes that it needs more time to analyze the implementation strategy and assessment mechanism, and expects to circulate a draft addressing these issues in January 2015.

U.S. Treasury officials have suggested that they have enough regulatory authority to adopt the rules through changes in U.S. regulations. In other countries it will depend on the source of their local documentation requirements. The OECD has not suggested a date by which most countries would be expected to adopt the new requirements. Our best guess is that the new requirements will become effective widely either for 2016 or 2017. Notwithstanding the delayed effective date, local examiners are not waiting for the official release and adoption of the new requirements. Local examiners in some countries are already requesting some of the global information contained in the CbC template during audits.

Clearly, the three-tier documentation process will increase global transparency. For some companies, the increased transparency may expose additional transfer pricing issues or inconsistencies in their transfer pricing practices that they may want to address before their first filing. In many situations, the increased transparency will put an additional premium on adoption and implementation of globally consistent transfer pricing policies.

The new requirements will require most companies to provide additional information in their documentation. The new CbC template will require companies to collect financial information that has never been collected in that form. In addition, the master file contains specific requirements for information that most companies have not previously collected. It is intended that both the CbC template and the master file be prepared by the parent company. For companies that do not have a centralized documentation process, these new requirements will likely require changes to their approach to transfer pricing documentation.

Next Steps

WP6 is expected to finalize 2014 transfer pricing deliverables of the BEPS Action Plan soon. The text is expected to be sent to the 44 members and associates of the OECD's Committee on Fiscal Affairs for discussion and final approval at their meeting at the end of June. The text adopted by the Committee on Fiscal Affairs is expected to be approved at the G20 meeting of finance ministers on September 20 and 21. Pascal Saint-Amans, Director of OECD's Center for Tax Policy and Administration, indicated at the Washington, D.C. conference that this version of the documents will be released to the public in September, shortly before the G20

meeting.

The U.S. Treasury Department's Deputy Assistant Secretary (International Tax Affairs), Robert Stack, is scheduled to speak at the International Tax Review Global Transfer Pricing Forum to be held in Washington on September 22-23, and his remarks will be closely followed. Companies should continue to closely monitor these developments and be prepared to make appropriate adjustments to their global transfer pricing policies and their approach to resolving transfer pricing disputes.

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