Global TP Alert 2015-016

OECD Releases Final BEPS Reports

The Organization for Economic Cooperation and Development (OECD) on October 5 released the final reports under the base erosion and profit shifting (BEPS) project it started two years ago to address perceived gaps in international tax rules. The final reports – one for each of the 15 items in the “Action Plan” released in 2013, except for the three transfer pricing actions, for which one report was issued – will be submitted to the G-20 finance ministers at their meeting in Lima, Peru, on October 8.

Key Transfer Pricing Concepts in Final Reports

The 186-page final transfer pricing report and the 70-page documentation and country-by-country reporting report provide guidance on a multitude of transfer pricing topics. Some of the salient features include the following:

Useful links

2015 Global Transfer Pricing Country Guide
Arm's Length Standard
Transfer pricing alerts
Deloitte tax@hand
Join Dbriefs
www.deloitte.com/tax

- **Global transfer pricing documentation and country-by-country reporting**. As expected, the OECD did not introduce any new guidance in the global documentation and CbC final report, which is simply a compilation of previously released deliverables.

- **Role of contracts.** The contractual arrangements between the parties is the starting place for the proper understanding (delineation) of a transaction. However, written contracts are unlikely to provide all the information necessary to perform a transfer pricing analysis. Therefore, the parties' actual conduct should be used to clarify or supplement the terms of the contract, or replace the contract if the contract is not supported by the conduct of the parties.

- **Risk.** To contractually assume risk, a party must exercise control over the risk and have the financial capacity to assume the risk. Although there is no bright line test to determine control over risk, the factors considered include: (1) performance of the decision to take risks; (2) the performance of responding to risks associated with the business opportunity; and (3) performance of risk mitigation activities. The guidance permits day-to-day risk mitigation activity to be outsourced as long as the party outsourcing the risk mitigation activity exercises control over the party doing the day-to-day risk mitigating activity. The guidance provides a six-step process to determine the entity incurring risk.

- **Intangibles.** The final report retains the 2014 guidance on categories of intangibles, transfer pricing methods, and important functions related to the development, enhancement, maintenance, protection, and exploitation of intangibles (the DEMPE functions). To be entitled to intangible returns associated with the DEMPE functions, the final report incorporates the control and funding requirements from the deliverable on risk, discussed above. The guidance states that the entity entitled to the profit or loss between projected and actual outcomes will be the entity exercising the control functions over the risks that caused the difference.

- **Funding and cash boxes.** An entity that does not control the financial risks associated with its funding will be entitled only to a risk-free return. An entity that does control the financial risks associated with the DEMPE functions will be entitled to a risk-adjusted return.

- **Recharacterization.** If a transaction lacks the commercial rationality of an arrangement that would have been agreed between unrelated parties, the guidance permits the nonrecognition of the transaction. The fact that a transaction is not observed between unrelated parties is not sufficient grounds for not recognizing the transaction.

- **Hard-to-value intangibles.** If the taxpayer cannot demonstrate that its pricing is based on a thorough analysis, the *ex post* outcome will be used as a presumptive evidence of the appropriateness of *ex ante* pricing arrangements. The OECD includes several exemptions to this rule based on unforeseeable events and adopts a five-year look-back rule with a 20 percent tolerance. They also allow taxpayers to bypass the provisions of this section by disclosing the underlying *ex ante* and *ex post* data and explaining why the variance was not anticipated.

- **Cost contribution arrangements.** The final report updates the CCA guidance to conform to the changes on contracts, risk, and intangibles discussed above. The guidance retains the requirement that ongoing contributions be valued at value rather cost unless the parties value the opportunity cost of the upfront commitment to contribute resources to the CCA.

- **Low-value-adding intragroup services.** To qualify for the safe harbor on low-value-adding intragroup services, taxpayers must document the cost pool and choose appropriate allocation keys. If the level of low-value-adding intragroup service fees exceeds a threshold determined by an individual country, tax administrations are able to require a full functional analysis and comparability analysis including the application of the benefits test to specific service charges.

- **Dispute resolution**. Twenty nations—Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the U.K. and the U.S.—have committed to provide for mandatory binding MAP arbitration in their bilateral tax treaties as a mechanism to guarantee that treaty-related disputes will be resolved within a specified time frame. Other countries have agreed to minimum standards and a peer review monitoring system.

- **Profit splits.** Final guidance on profit splits has been postponed until 2016 and 2017.

Deloitte Webcasts and Publications

The final reports and related materials, including *Aligning Transfer Pricing Outcomes with Value Creation – Actions 8-10*, and *Transfer Pricing Documentation and Country-by-Country Reporting – Action 13* are available on the OECD's website.

Deloitte Tax will conduct a series of webcasts to discuss all aspects of the OECD transfer pricing deliverables. To register, follow the links below:

ASIA-PACIFIC:

- Base Erosion and Profit Shifting: The Final Reports (Part 1: Transfer Pricing), October 28, 11:00 AM HKT
- Base Erosion and Profit Shifting: The Final Reports (Part 2: Non-Transfer Pricing), November 4, 2:00 PM HKT
- BEPS: Implementation of Transfer Pricing Changes (Part 1: Australia, Japan, China, and Korea), November 26, 2:00 PM HKT
- BEPS: Implementation of Transfer Pricing Changes (Part 2: India and Southeast Asia), December 8, 2:00 PM HKT

EMEA:

- G20/OECD - BEPS: Round-up of 2015 Deliverables, October 20, 1:00 PM BST
- G20/OECD - BEPS: Transfer Pricing – Risk and Recharacterization, October 28, 2:00 PM GMT
- G20/OECD - BEPS: Transfer Pricing of Intangibles, Hard-to-Value Intangibles and Cost Contribution Arrangements, November 12, 12:00 noon GMT

UNITED STATES:

- BEPS Update: Release of the Final Package, October 9, 2:00 PM ET
- OECD Transfer Pricing Guidelines: After Crossing the Finish Line, What's Next?, October 27, 2:00 PM ET

Deloitte's transfer pricing practice is preparing a suite of 10 articles to explore in depth the changes brought about by the final BEPS report on transfer pricing and country-by-country reporting. To receive these articles when released, subscribe to our transfer pricing newsletter, *The Arm's Length Standard* or visit the transfer pricing page on Deloitte.com.

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