



# TRANSFER PRICING

## STATUS UPDATE

7<sup>th</sup> July 2015



## Aim of presentation and discussion

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- Give a full status update on the TP work under BEPS
- Give feedback on how the significant input provided during the public consultations has been taken into account
- Inform stakeholders about the next steps



# Changes to the TPG / work streams

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## Chapter I TPG:

- Delineation of the actual transaction, risk and recognition of the accurately delineated transaction (2015), locational advantages, workforce in place, synergistic benefits (2014)

## Chapter II TPG:

- Commodity transactions. *Recently approved by WP6*

## Chapter V TPG.

- TP documentation. *Finalised [Action 13]*



# Changes to the TPG / work streams

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## Chapter VI TPG:

- Intangibles including Hard to Value Intangibles (2014 and 2015)

## Chapter VII TPG:

- Low Value Adding Services. *Broad agreement to implement. A full TP analysis will be allowed if deductions are higher than a certain threshold.*

## Chapter VIII TPG:

- Cost Contribution Arrangements



## Changes to the TPG / follow up work

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1. Profit splits (Chapter II TPG).
2. Financial transactions (Chapter I, VII of the TPG).
3. Profit attribution to PEs (Action 7).
4. Work on implementation Hard to Value Intangibles.



# Chapter I

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## Delineation of the actual transaction

- Clarity provided on the relationship between contractual arrangements and conduct
- Contractual arrangements form the starting point of the analysis
- Knowing the conduct is relevant to assess whether there are contradictions between contractual arrangements and conduct, to fill in gaps in the contractual arrangements and to interpret the contracts for TP purposes



# Chapter I

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## Risk

- The guidance on risk is now part of the guidance on the functional analysis
- A materiality threshold is included: economically significant risks need to be identified with specificity
- Based on the comments received, the draft does not include anything on moral hazard and recognises risk-return trade offs
- Control over risk has been clarified
- Financial capacity to assume a risk is included as a criterion on equal footing with control in the analysis on assumption of risk
- The special character of the financial services industry and the interaction between the proposed guidance and the future work on financial transactions is recognised



# Analytical framework on risk

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1. Identify economically significant risks with specificity
2. Identify contractual assumption of the specific risk
3. Functional analysis. Establish conduct and other facts
4. (i) is the contractual assumption aligned with the conduct and the other facts of the case? (ii) is the party assuming the risk under (i) exercising control and does it have the financial capacity to assume the risk?
5. If the party assuming the risk does not control the risk or does not have the financial capacity to assume the risk, then allocate the risk to the group company having most control and having the financial capacity to assume the risk
6. Price, taking into account the full functional analysis of the transaction, including the analysis on risk.





# Control

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- In response to comments received, WP6 has incorporated the notion that risk mitigation and preparatory work relating to the decision making may be outsourced. If such activities are outsourced, the group company in control of the risk should set the objectives of the outsourced activities, assess whether the objectives are met and hire or fire the service provider.
- The guidance recognises that the parties performing risk mitigation activities and the parties making the decisions that shape the policy environment in which the specific risks are assumed do not exercise control over the specific risk.
- It is also recognised that the mere formalising of decision making in the form of, for example, minutes of a board meeting and signing of the documents of a board meeting, does not qualify as exercising a decision making function sufficient to demonstrate control over risk.



## Financial capacity to assume a risk

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- Not only equity levels are deemed to be relevant
- The relevant test relates to access to funding on the basis that the associated enterprise is operating as an independent party in the same circumstances as the associated enterprise



# Cash boxes

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- Cash box = capital rich entity with low or no functionality
- If the cash box is not exercising control over the financial risk that is connected with the provision of the funding, then the risk is allocated to the group entity that is performing such control functions
- The non-recognition rules may also be applicable
- The cash box gets no more than a risk free rate of return for the funding itself
- Other measures that will impact the cash box: interest deductibility rules, CFC rules, minimum standard on treaty abuse and application of domestic anti-abuse rules
- **No special measures were deemed necessary**



## Recognition of the accurately delineated transaction

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- Non recognition builds on the existing guidance and therefore links to the notion of commercial rationality
- New examples are included that do not depend on behaviour or on moral hazard



## Chapter VI on intangibles

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- No fundamental changes are needed to the guidance developed in 2014
- Corresponding changes based on the new guidance on risks and recognition of the accurately delineated transaction are necessary
- Additional guidance on the allocation of the difference between the actual and the expected profits is included: this allocation will be determined by the way the risks that were assumed by group companies play out
- Information asymmetry issues and the risk of mispricing is addressed through the guidance on Hard To Value Intangibles.



# Profit Splits

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- The scoping of the work to be undertaken benefited greatly from the public consultation on this issue
- There is recognition that the aim should be to identify the most appropriate method for the case
- Therefore the aim of the follow up work on profit splits is to unlock the potential of useful guidance within the framework of the most appropriate method rule.



## Dispute resolution: Action 14

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- Two building blocks:
  - A mandatory minimum standard and an associated monitoring process
  - A voluntary commitment to mandatory and binding arbitration
- The minimum standard recognises that access to MAP should be provided for TP cases, also if article 9 (2) is missing in a treaty
- 90% of the existing MAP cases are covered when the countries that expressed commitment to mandatory and binding arbitration implement this commitment



## Next steps

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- Public consultation on CCAs and Hard to Value Intangibles on July 6 and 7
- WP 6 meetings until July 10<sup>th</sup>
- Finalisation by WP6 in July
- August: processing of the papers
- September: formal approval CFA
- Early October: approval Council
- October 8<sup>th</sup> G20 Finance Ministers Meeting