OECD

Caroline Silberzstein
OECD Centre for Tax Policy and Administration, Paris

The OECD has an extremely ambitious programme of work planned for 2011

On July 22, 2010, the Council of the OECD approved the 2010 update of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereafter "TPG"), which is the first substantive revision of the TPG since 1995. On the same day as it approved the 2010 TPG, the Council of the OECD approved the 2010 update to the Model Tax Convention and the 2010 Report on the Attribution of Profits to Permanent Establishments.[1] This marked the completion of three major transfer pricing projects that have kept Working Party No. 6 of the Committee on Fiscal Affairs busy for several years: the review of comparability and of profit methods; the examination of the transfer pricing aspects of business restructuring; and the development of guidance on the application of the arm's length principle to the attribution of profits to permanent establishments. The OECD is now starting a new programme of work. Below is a brief description of the transfer pricing highlights.

I. Transfer pricing and intangibles

The main new project will be an examination of the transfer pricing aspects of intangibles, which should lead to a revision of the existing guidance in Chapters VI and VIII of the TPG. Chapter VI of the TPG contains special considerations for intangible property and Chapter VIII contains guidance on cost contribution arrangements. These two chapters date back to 1995-1997 and are no longer sufficient to address all the transfer pricing issues encountered in today's business transactions and transfer pricing practices. Intangibles are an essential part of value creation in today's economy and raise complex and challenging issues in the transfer pricing area.

Many of the issues addressed in the 2010 revision of the TPG are relevant to intangible transactions. In particular, Chapter II provides guidance on the selection of the most appropriate transfer pricing method to the circumstances of the case and expanded guidance on the application of a profit split method where both parties to a transaction contribute unique and valuable intangibles. Chapter IX provides new guidance on risks and on intangible transfers. Further relevant guidance is found in Chapter II in relation to the application of the transactional net margin method, in Chapter III in relation to comparability analyses, and in Chapter IX on business restructurings. A number of issues specific to intangible transactions were however left aside in the 2010 revision of the TPG. In the process that led to the development of the 2010 TPG, it became obvious that countries have differing approaches to some of the issues related to intangibles, and that the existing international guidance in this area is insufficient. After the work done on the attribution of profits to permanent establishments and on business restructurings, the OECD intends to tackle, with this new project, one of the most complex and controversial areas of transfer pricing today.

Public comments were invited in July 2010 on what interested parties saw as real issues in practice and shortfalls in the existing guidance, on the areas in which they believed that the OECD could usefully do some further work, and on what they believed the format of the final output should be. Fifty written contributions were received in response to this invitation to comment, most of which are available on the OECD Internet site.[2] A consultation with business commentators took place at the OECD headquarters in Paris on November 9.

During the consultation process, most commentators requested the OECD to develop clearer international guidance and provide more certainty on issues in relation to the definition of intangibles. New notions are being discussed by transfer pricing practitioners, beyond the traditional forms of intangibles. They generally relate to elements that contribute to the creation of value but may not be legally protectable and may not be recognised as intangible assets for accounting and general tax purposes, and give rise to significant uncertainty as to their correct transfer pricing treatment. The list includes workforce in place, a commitment to undertake research and contribute to the development of future intangibles, goodwill, going concern, profit potential, business opportunities, value drivers, first mover advantage, and many others.

Commentators also requested further guidance on the determination of whether a compensable transaction involving the use and/or transfer of an intangible has taken place and on the identification and charac-

Caroline Silberztein is Head of the Transfer Pricing Unit at the OECD

terisation of intangible transfers. They raised questions in relation to the factors to be considered to determine whether all intangible property rights, partial intangible property rights, or valuable or low value services have been transferred; consideration of factors informing whether intangible property has been transferred in isolation or in conjunction with tangible assets, business operations, other intangible assets, etc.; and consideration of the form of the transfer.

Another area where further guidance is needed relates to the notions of legal and economic ownership of intangibles. Specifically, the question relates to the circumstances where an enterprise that is not the legal owner of an intangible should nevertheless be entitled, at arm's length, to share in any additional return attributable to the development or exploitation of that intangible, for example because it has incurred significant risk and expenses related to the development of an intangible or the enhancement of its value. An example is currently found at paragraphs 6.36-6.39 of the TPG dealing with marketing activities undertaken by enterprises not owning trademarks or trade names. The question of the attribution of the economic benefits derived from the development or exploitation of an intangible, by contrast to its legal ownership, is sometimes referred to as "economic ownership". Commentators requested clarification of this notion and its usefulness in an Article 9 context, and how it may differ from the notion of economic ownership developed under the Authorised OECD Approach to attribute profits to a permanent establishment under Article 7 of the Model Tax Convention.

Commentators also raised issues in relation to cost contribution arrangements ("CCAs") which are sometimes used by multinational enterprises to organise the development and ownership of valuable intangibles. The existing OECD guidance on CCAs at Chapter VIII of the TPG leaves a number of areas open to possible controversies, including issues related to the characterisation of intangibles transfers made at the inception of a CCA and issues related to the valuation of the contributions made by the participants in a CCA.

Commentators cited the lack of sufficient guidance on intangibles valuation, including issues in relation to the acceptability of valuation methods used for non-tax purposes, comparability analyses, the determination of the relevant parameters to be used in a valuation model, and the valuation of bundled transactions involving complex intangibles and intangibles embedded in services and/or goods. Important questions were raised in relation to intangibles transferred at a point in time when valuation is highly uncertain, including the circumstances where this would lead to retrospective analyses and whether the use of post-transaction or post-filing information may or may not constitute hindsight in such circumstances. Questions were also raised as to how to take into account the perspectives of both the transferor and the transferee in a valuation process and whether or not valuation should be based on the "highest and most productive use" of the transferred intangible.

A few commentators requested industry-specific guidance, for the pharmaceutical industry or the financial industry, for example, but others thought that the guidance developed should remain generic. All commentators were eager to see more and clearer consensus guidance in order to prevent and resolve transfer pricing disputes and the double taxation that they cause. Several commentators pointed to the need to involve non-OECD economies in the process and to monitor the outcomes of the project.

The intention is for the OECD to release publicly by the end of January 2011 or early in February a scoping paper reflecting the outcomes of the consultation process and to start its substantive discussions in March 2011. The scope of such a project is potentially extremely broad and the OECD needs to prioritise the issues that it will take on board, especially as commentators and governments agree that this work should be conducted in a timely manner. The project will be carried out by Working Party No. 6 of the Committee on Fiscal Affairs on the Taxation of Multinational Enterprises, through a Special Session on the Transfer Pricing Aspects of Intangibles ("WP6 TPI") set up for this purpose. The WP6 TPI is open to all interested member countries and Observers.[3] Substantial involvement from the business community will be sought. The OECD hopes to be able to release a discussion draft for public comment by the end of 2013.

II. Applying the arm's length principle in practice: monitoring activities and administrative aspects

The OECD also intends to increase its monitoring activities in order to promote a more consistent application of the TPG in member countries, thus pursuing its efforts to prevent transfer pricing disputes and eliminate double taxation. In this respect, a review of the use of post-transaction or post-filing data by taxpayers or by tax administrations and of the circumstances where it may or may not constitute hindsight is in process. The OECD also intends to carry out a review of the transfer pricing issues most commonly encountered in MAP procedures.

From the practical implementation side, the OECD is launching a review of transfer pricing administration techniques that may be implemented by countries to optimise the use of taxpayers' and tax administrations' resources. A review is in process of the administrative simplification measures (including, for example, safe harbours) that member countries and Observers have or may be considering in the transfer pricing area and the intention is for the OECD to re-examine its existing guidance in Chapter IV of the TPG on safe harbours to determine whether and if so how it might need to be updated to reflect the experience acquired by countries and taxpayers since 1995.

III. Conclusion

Immediately after the completion of a major revision of the TPG, the OECD is starting an extremely ambitious programme of work. It aims at balancing the development of sophisticated guidance, needed for sophisticated transactions such as intangibles transactions, with monitoring activities and the promotion of administrative practices designed to make things more consistent and effective in practice.

At the same time, the OECD is enhancing its dialogue with non-OECD economies on theoretical questions and practical implementation aspects of the arm's length principle and TPG. Many non-OECD economies are key players in the transfer pricing arena and should be part of the dialogue on global transfer pricing approaches. Furthermore, transfer pricing is also identified as one major component of the debate on tax and development and it is important that the voices of developing and transitioning economies be heard. The challenge ahead is to keep all interested parties engaged in a common dialogue and to promote principled guidance that can apply to a range of transactions, from the simplest to the most complex, and to countries at various stages of their economic development.

Caroline Silberztein is Head of the Transfer Pricing Unit at the OECD Centre for Tax Policy and Administration in Paris. She may be contacted at:
Caroline.SILBERZTEIN@oecd.org
The views expressed in this article are those of the author, not necessarily those of the OECD and its members.
www.oecd.org

NOTES

[1] See www.oecd.org/ctp/tp

[2] See www.oecd.org/ctp/tp/intangibles

[3] In January 2011, the OECD has 34 member countries, see www.oecd.org/document/25/0,3343,en_36734052_36761800_36999961_1_1_1_1,00.html. Observer countries to the Committee on Fiscal Affairs are Argentina, China, India, the Russian Federation and South Africa.

TPIJ ISSN 2042-8154