General Report

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Summary and conclusions

At the heart of the base erosion and profit shifting (BEPS) project are discussions regarding the control of transfer pricing in transactions involving related entities. Not only is transfer pricing the direct object of no fewer than four BEPS actions – 8–10 and 13 – it is also indirectly linked to several others.

The analysis of the branch reports demonstrated that the OECD transfer pricing guidelines are the most influential transfer pricing standard in the participating IFA branches. Even developing jurisdictions refer to the OECD standard as the basis for their transfer pricing, or as a secondary support document. Few branch reports refer to diverging practices: the only example of significantly divergent practice is the case of Brazil.

Most jurisdictions are committed to the adoption of the BEPS project outcomes, at least to some extent. However, some branch reporters stated that the reaction to the BEPS project from the business community had not been as positive as that from government, tax authorities and academia.

Regarding transactions with intangibles, most branches reported that their jurisdictions did not have specific rules for defining intangibles or transactions with intangibles. Similarly, most branch reporters commented that their jurisdictions apply a substance-over-form approach to transfer pricing – even though very few have specific rules on the matter. Even jurisdictions that are generally formalistic make an exception for transfer pricing. Across the board, there have not been any significant developments in the fields of hard-to-value intangibles and cost contribution agreements (CCAs). Some jurisdictions mentioned their experience with the analysis of group synergies. However, there have been no significant advances in this area.

In respect of the provision of low value-adding services, even though jurisdictions may move in the direction of applying a simplified, fixed margin methodology in this case, there is no indication that this may lead to the application of simplified methodologies in other areas.

Even though a substance-over-form approach is part of the future of transfer pricing, there has not been a massive turn in the direction of the functional and risk analysis proposed by the OECD.

In relation to transactions with commodities, only a few jurisdictions have enacted the "sixth method" – mostly in Latin America. Most jurisdictions use the comparable uncontrolled price (CUP) as the applicable methodology for transactions with commodities.

In reviewing the branch reports, it is possible to state that, even though the use of profit splits is possible in several jurisdictions, there are only a few that use the method customarily. On the other hand, there is a perception that the increase in the use of the profit split method will also increase litigation, and potentially double taxation.

Considering transfer pricing documentation requirements, it is possible to state that:

- Country-by-country reporting will be a reality. In most cases jurisdictions will also implement – or already have in place – the master and local file requirements.

- In general, there is a concern that the new transfer pricing documentation package will increase the compliance costs for multinational companies (MNEs), even though a few branch reporters mentioned that this would only happen in the early years of implementation.
- With respect to the potential upsides of the BEPS project outcomes, five items can be singled out:
  - the new obligations may provide more certainty and assist companies in complying with their domestic obligations;
  - companies will benefit from the overall improved and more thorough treatment of group economic information;
  - transfer pricing harmonization will help avoid double taxation;
  - improvements are likely in dispute resolution;
  - the damage caused to companies' images by tax scandals may start to be overcome by the perception that gaps that allow aggressive tax planning are being closed.

The BEPS project work on transfer pricing is not a finishing line, but another step in the development of rules that are effective in the fair allocation of taxing rights among jurisdictions in cross-border transactions within MNE groups. Therefore, one of the major goals of this General Report was to invite IFA's branch reporters to comment on what the future holds. A summary of comments from branch reporters is included in the list below:

- The arm's length principle – even in a revised form – will remain the dominant criterion for allocating taxing rights in cross-border transactions within MNE groups.
- One future trend will be alignment with the transfer pricing BEPS outcomes, indicating that the reshaped arm's length principle will become the standard.
- The new approach to the arm's length principle will tend to increase the number of cases of double taxation.
- The BEPS project has raised awareness of the problems existing in the allocation of taxing rights in cross-border transactions within MNE groups. In this context, some branch reporters foresee a future where audits will be increased as tax authorities try to collect more tax revenue, which may increase transfer pricing disputes. Therefore, the future of transfer pricing includes a focus on the avoidance of double taxation and dispute resolution.
- In the European context, some reports pointed out that the future of transfer pricing may hold some degree of harmonization, in the context of the debates revolving around the common consolidated corporate tax base (CCCTB).
- Some argued that the future of transfer pricing may bring about an increase in the use of profit split mechanisms, considering the shortcomings of the traditional arm's length approach.
- There was also reference to the "popularization" of transfer pricing debates.
- A tendency to prefer economic substance over legal form was identified. Even reporters from jurisdictions where legal formalism still prevails as a rule noted that transfer pricing was an exception to this general rule.
- Along these lines, there is a clear trend for the complete disregard of extreme business models and structures that rely only on a strict formalist transfer pricing approach.

- Even though there is no indication that an extremely simplified approach, such as that found in Brazil, will become a global standard, there is some movement in the direction of simplification, as seen in the case of transactions with commodities and low value-adding services.

1. Introduction

The BEPS project has certainly been the most influential factor in international taxation in recent decades. Some of the circumstances that made BEPS possible – such as globalization and harmful tax competition – are not new. However, the development of the digital economy has created problems that did not exist in an industrial-based economy. The rise of services and intangibles has changed the face of cross-border transactions,[1] putting in jeopardy states' capacity to collect their fair share of tax in such areas. Finally, the global financial crisis set the stage and forced jurisdictions to act. The decline in tax collection harmed jurisdictions' capacity to maintain levels of welfare – in the case of developed jurisdictions – and negatively affected flourishing developing nations.

At the heart of the BEPS project are discussions regarding the control of transfer pricing in transactions involving related entities. Not only is transfer pricing the direct object of no fewer than four BEPS actions – 8–10 and 13 – it is also indirectly linked to several others. One might agree with Yariv Brauner when he states that "[a]ggressive transfer pricing is the beating heart of BEPS planning – the *sine qua non* of the transactions that triggered the universal interest in BEPS and eventually the BEPS project".[2] In another text, the same author has claimed that "[t]ransfer pricing is by far *the* single most important and impactful tool among the current international tax planner's tools of trade".[3] That is why the European Union reporters have pointed out that "BEPS resulting from the misuse or manipulation of transfer prices has been identified as a priority in the EU Commission's corporate tax agenda".[4]

For several decades, transfer pricing analysis has been equivalent to the application of the arm's length principle, which is considered to be the cornerstone of the transfer pricing international tax regime.[5] Again according to Yariv Brauner, "[t]he arm's length standard is the heart, spirit and the foundation of the current

1 See Maurício Braga Chapinoti, "Application of Arm's Length Principle to Intangibles" (2007) 23 (6) *International Transfer Pricing Journal*, p. 100. Also see Martin Lagarden, "Intangibles in a Transfer Pricing Context: Where Does the Road Lead?" (2014) 21(5) *International Transfer Pricing Journal*, p. 331.

2 Yariv Brauner, "What the BEPS" (2014) 16(2) *Florida Tax Review*, p. 96.

3 Yariv Brauner, "Transfer Pricing in BEPS: First Round – Business Interests Win (But, Not in Knock-Out)" (2015) 43 (1) *Intertax*, p. 72.

4 See section 2.1 of the European Union report.

5 As pointed out by Raffaele Petruzzi, "Since that moment [1933], the arm's length principle has been the preferred method for allocating business income between head offices and permanent establishments and also between related companies both in the OECD Model Tax Convention on Income and on Capital (OECD Model) and in the United Nations Model Double Taxation Convention Between Developed and Developing Countries (UN Model) as well as being the relevant principle embedded in most transfer pricing rules around the world": Raffaele Petruzzi,

transfer pricing regime".[6] However, as changes in the economic environment came into play, it became clearer and clearer that the existing rules were no longer capable of correctly allocating income among jurisdictions in the global economy.

As noted by Sébastien Gonnet, "[a]lthough markets and business have globalized, taxation of business had not kept pace; global profits (per business unit or industry group) had to be converted and adapted exclusively for purposes of calculating national corporate income tax bills".[7]

The arm's length principle was conceived as a criterion for allocating taxing rights among jurisdictions arising from international transactions.[8] As Scott Wilkie correctly puts it, "[f]undamentally, transfer pricing attempts to illuminate the organizational and qualitative source of income".[9] Notwithstanding, as pointed out by the same author, "In the absence of significant international synchronicity – there is no world tax order, legislator, or administrator – the leaves may fall where they fall, *too often it came to be thought in places where there are no trees*"[10] (emphasis added).

Originally, the arm's length principle was based on three pillars, as highlighted by Raffaele Petruzzi: "the fiction of separate legal entities (the so-called separate entity approach), the relevance of the contractual arrangements, and the comparability of the transaction".[11]

However, the foundations of these pillars are not as strong as expected. The fiction of separate legal entities disregards the argument that "[t]he very existence of integrated multinationals is evidence that the ALS [arm's length standard] does not reflect economic reality".[12] In other words, the arm's length principle – at least in its pre-BEPS form – mainly viewed transactions within MNE groups as transactions between independent entities.[13] However, transactions within MNEs are far

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"The Arm's Length Principle: Between Legal Fiction and Economic Reality", in Michael Lang *et al.* (eds.), *Transfer Pricing in a Post-BEPS World* (The Netherlands: Kluwer, 2016), p. 9.

6 Yariv Brauner, "Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes" (2008) 28(79) *Virginia Tax Review*, p. 96.

7 Sébastien Gonnet, "Risks Redefined in Transfer Pricing Post-BEPS", in Michael Lang *et al.* (eds.), *Transfer Pricing in a Post-BEPS World* (The Netherlands: Kluwer, 2016), p. 34.

8 This view is not uniform among international tax scholars. For instance, in Luís Eduardo Schoueri's interpretation, "Although the ALS has been said to provide fairness in the distribution of tax revenues among states, its rationality should be considered based on its original intent, i.e. the need for equality between related and unrelated firms." Luís Eduardo Schoueri, "Arm's Length: Beyond the Guidelines of the OECD" (2015) 69 (12) *Bulletin for International Taxation*, p. 695.

9 Scott Wilkie, "Transfer Pricing Aspects of Intangibles", in Michael Lang *et al.* (eds.), *Transfer Pricing in a Post-BEPS World* (The Netherlands: Kluwer, 2016), p. 83. This is also the view of Jens Wittendorff, according to whom, "Transfer pricing is increasingly seen as concerning the international income allocation between states." Jens Wittendorff, *Transfer Pricing and the Arm's Length Principle in International Tax Law* (The Netherlands: Kluwer, 2010), p. 8. Also see Georg Kofler, "Article 9", in Ekkehart Reimer and Alexander Rust (eds.), *Klaus Vogel on Double Taxation Conventions*, 4th edn (The Netherlands: Kluwer, 2015), vol. I, p. 605.

10 Wilkie, *op. cit.*, p. 68.

11 Petruzzi, *op. cit.*, p. 11.

12 Reuven S. Avi-Yonah, "The Rise and Fall of Arm's Length? A Study in the Evolution of US International Taxation" (2007) *University of Michigan: Law & Economics Working Papers*, p. 24.

13 As Scott Wilkie points out, "The transfer pricing paradigm assumes that these 'transactions' should take place without distortions induced by common ownership of the parties so as to take advantage of the presumptive lack of genuine adversity of interest between them in striking their erstwhile

from equivalent to dealings between independent entities. As noted by Luís Eduardo Schoueri, "[i]nternationalization allows integrated enterprises to carry out transactions more efficiently than independent enterprises, which must follow market prices".[14]

On the other hand, the reliance on a formal analysis of the terms and conditions of intra-group transactions also distanced transfer pricing analysis from the actual economic substance of the transactions, leading to "leaves falling where there are no trees", in Scott Wilkie's words quoted above.[15] According to Sébastien Gonnet, "[r]isk was captured in contractual stereotypes that perfectly matched the requirements of applying TNMM [transactional net margin method] but lost connection with realities inside MNE business".[16]

The formalistic analysis of international transactions has particularly distorting effects in operations involving intangibles. More often than would be expected, entities that did not contribute to the creation of an intangible – or that do not bear the risks associated with it – end up entitled to the income it generates. Moritz Hiemann and Stefan Reichelstein have analysed this aspect. According to them, "[i]n the current debate over formula apportionment versus traditional arm's length transfer pricing, advocates of formula apportionment frequently point out that the ease of transferring intangible assets has effectively rendered the arm's length standard dysfunctional".[17]

In addition, the weight laid on the comparability of transactions, which is expected to serve as an instrument for the definition of the arm's length price, has its shortcomings. As pointed out by Reuven Avi-Yonah:

> "[p]roblems with the current system derive not from rules at its periphery, but instead from a fallacy that lies at the system's core: namely, the belief that transactions among unrelated parties can be found that are sufficiently comparable to transactions among members of multinational groups that they can be used as meaningful benchmarks for tax compliance and enforcement…"[18]

Even though nothing indicates that the arm's length principle will be set aside as the primary criterion for allocating taxing rights in transactions between related parties,[19] the fact of the matter is that the BEPS project outcomes are just one more step in the direction of a renewed version of the arm's length principle. The report on Actions 8–10 advocates that "[t]he guidance on the arm's length principle … be clarified and strengthened, and furthermore, if transfer pricing risks remain after

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commercial bargains." Scott Wilkie, "The Definition of Ownership of Intangibles: Inside the Box? Outside the Box? What is the Box?" (2012) 4(3) *World Tax Journal*, p. 226.

14 Schoueri, *op. cit.*, p. 698.

15 Wilkie, "Transfer Pricing Aspects of Intangibles", *op. cit.*, p. 68.

16 Gonnet, *op. cit.*, p. 35.

17 Moritz Hiemann and Stefan Reichelstein, "Transfer Pricing in Multinational Corporations: An Integrated Management and Tax Perspective", in Wolfgang Schön and Kai A. Konrad (eds.), *Fundamentals of International Transfer Pricing in Law and Economics* (Berlin: Springer, 2012), p. 11.

18 Reuven Avi-Yonah, "Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation" (2010) *World Tax Journal* 2(1), p. 8.

19 Petruzzi, *op. cit.*, p. 28; Schoueri, *op. cit.*, p. 716.

clarifying and strengthening the guidance, the BEPS Action Plan foresaw the possibility of introducing special measures *either within or beyond the arm's length principle*"[20] (emphasis added).

Indeed, the idea that related entities are operating independently is replaced by the view that "MNE groups and the associated enterprises that comprise such groups may benefit from interactions or synergies amongst the group members that would not be generally available to similarly situated independent enterprises".[21]

The approach based on the legal form is balanced by the consideration of the economic features of the transaction. According to the BEPS report on Actions 8–10, "[t]he transfer pricing analysis will have identified the substance of the commercial or financial relations between the parties, and will have accurately delineated the actual transaction by analysing the economically relevant characteristics".[22]

Finally, the usual comparability analysis may be replaced by simplified methodologies in some special situations, such as for low value-adding services, transactions with commodities, or the emphasis on profit splits as the "go to" method in some circumstances. According to Mirjam Koomen:

> "A broadened interpretation of the arm's length principle, including special measures beyond the arm's length principle, are contemplated in this BEPS era in order to address the alignment of value creation with transactions with reported profits. Options such as profit split methods, formulary arrangements, recharacterization, reallocation of profits, commensurate-with-income standards and price adjustment clauses are considered and briefly mentioned here."[23]

The risk and functional analysis proposed by the OECD is far from being immune to criticism. Most will generally agree with Sébastien Gonnet's commentary, when he states that "[t]he new OECD risk process may prove as advantageous for tax authorities when strongly criticizing extreme circumstances where risk follows neither the functions nor the financial capacity; cash boxes illustrate good examples of such a situation". Notwithstanding, as he correctly puts it, "[w]hat about the rest, i.e. the non-extreme situations? In most situations, defining risk, identifying risk management and financial capacity are not as obvious and free from ambiguity."[24]

It is also fair to state that a model based on functions and risks may bring additional complexity for developing jurisdictions. Moreover, one of the most relevant aspects from a developing country's perspective – the consumer market – has been entirely forgotten by the OECD. As noted by Marta Milewska:

[20] OECD, Aligning transfer pricing outcomes with value creation, Actions 8–10, 2015 final reports (Paris: OECD, 2015), p. 9.

[21] *Ibid.*, p. 47. As pointed out by Mirjam Koomen, "MNEs generate economic profits. The arm's length principle, as originally developed, captured the economic profit by retaining the residual profit within the residence state of the MNE after remuneration of the outlying establishments for their services. Many MNEs are far more integrated than typically was true in the past, however, and the residual economic profit is no longer necessarily related to one separate central and vital entity." Mirjam Koomen, "Transfer Pricing in a BEPS Era: Rethinking the Arm's Length Principle – Part II" (2015) 22(4) *International Transfer Pricing Journal*, p. 240.

[22] OECD, *op. cit.*, p. 38.

[23] Koomen, *op. cit.*, p. 242.

[24] Gonnet, *op. cit.*, p. 40.

"In addition to resources and capabilities, which converge and transform into competitive advantages, market characteristics also may have an impact on profitability under industrial organization economics. Although academic studies show that an entity's competitive advantages (rather than market characteristics) are the main source of long-term premium profitability, market characteristics may boost the entity effect on profitability. In that sense, it is noteworthy that the market power of entities has its basis in entity resources. For instance, the prerequisite for market power may be the presence of barriers to entry or vertical bargaining power, which have the effect of reducing or limiting competition by preventing potential competitors from entering a market."[25]

The complexity of the current business environment has checked current transfer pricing control mechanisms. However, it is unclear whether the new model will resolve the problems or just increase complexity. This is the background against which the branch reports were prepared. Their focus was to adapt this international context to a domestic framework and attempt to ascertain the future of transfer pricing.

2. Transfer pricing and previous congresses

The Rio de Janeiro Congress is not the first to have transfer pricing as one of its main subjects.

Subject 1 of the Cancun, Mexico, Congress of 1992 was *Transfer pricing in the absence of comparable market prices*. Its General Reporter was Guglielmo Maisto, who, at that time, supported the need for closer attention to transfer pricing from IFA. In his words, the need for the analysis presented in subject 1 of the Cancun Congress was "also suggested by the limited attention given by IFA to the subject matter. In particular IFA has dealt, in the past, with transfer pricing only in a limited, peripheral or ancillary fashion."[26]

Transfer pricing was again the focus of an IFA congress in 2007. Subject 1 of this congress, which was held in Kyoto, Japan, was *Transfer pricing and intangibles*. The General Reporter in this case was Toshio Miyatake. The issues that were analysed in this report are closer to the topics that are the focus of the BEPS project. In his conclusion, the General Reporter stated that "[c]oncrete measures are required to achieve better circumstances for the application of appropriate uniform transfer pricing rules to intangible transactions".[27]

This General Report – as well as the debates that will take place during the Rio de Janeiro Congress, under the coordination of Professor Luís Eduardo Schoueri – renews IFA's commitment to the study of transfer pricing. It is not the end of the road, but one more step along the way.

[25] Marta Milewska, "A Mexican Perspective on Value Creation under the OECD's BEPS Approach to Transfer Pricing" (2017) 24(1) *International Transfer Pricing Journal*, p. 52.

[26] Guglielmo Maisto, General Report, in IFA, *Cahiers de droit fiscal international*, vol. 77a, *Transfer pricing in the absence of comparable market prices* (IFA: The Netherlands, 1992), p. 20.

[27] Toshio Miyatake, General Report, in IFA, *Cahiers de droit fiscal international*, vol. 92a, *Transfer pricing and intangibles* (IFA: The Netherlands, 1992), p. 36.

3. Outline and branch reports

The outline sent to branch reporters invited them to start their analysis with an overall assessment of their current domestic transfer pricing policy, regulations and practice. The core of the reports' outline was the request to reporters to comment on how the BEPS project had affected their jurisdiction's transfer pricing policies and practices. Reporters were also requested to comment on how the proposed changes in transfer pricing would potentially affect transfer pricing documentation and compliance costs and whether the BEPS project might work in favour of companies. Finally – and this part may be considered the end-goal of the reports – reporters were invited to present their views on the future of transfer pricing.

The General Reporter received 44 reports from the European Union and the following jurisdictions: Argentina, Australia, Austria, Belgium, Bolivia, Brazil, Bulgaria, Canada, Chile, Chinese Taipei, Colombia, the Czech Republic, Denmark, Finland, France, Germany, Hungary, India, Italy, Japan, Korea, Liechtenstein, Luxembourg, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Peru, Poland, Portugal, Serbia, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, the United States of America, Uruguay and Venezuela. The reports reflect the effort of all reporters to provide relevant information from their jurisdiction, which was helpful and essential for the preparation of this General Report. The General Reporter is grateful for all the branch reporters' hard work.

In the observations in the sections below, the report has tried to use the branch reports as extensively as possible. However, the reader will notice that in those instances where this report makes references to certain branch reports, most of the time not all the branch reports are mentioned. This only happened in those cases where a particular report did not make explicit reference to the issue under analysis, considering the specific focus of the General Reporter.

4. The influence of the OECD

As pointed out by Yariv Brauner, "[t]he OECD was not only charged by the G20 to lead the BEPS project with no supervision beyond the highest political levels but also succeeded in positioning itself as an independent partner to the G20, taking ownership of the project rather than acting in a subordinate role".[28] The OECD's leadership in international taxation goes beyond the BEPS project. It is well known that most of the double tax conventions currently in force are directly or indirectly based on the OECD model.[29] The analysis of the branch reports reinforces the fact that the OECD is also a major influence when it comes to transfer pricing policy.

[28] Yariv Brauner, "Transfer Pricing Aspects of Intangibles: The Cost Contribution Arrangement Model", in Michael Lang *et al.* (eds.), *Transfer Pricing in a Post-BEPS World* (The Netherlands: Kluwer, 2016), p. 100.

[29] See Pasquale Pistone, General Report, in Michael Lang *et al.* (eds.), *The Impact of the OECD and UN Model Conventions on Bilateral Tax Treaties* (Cambridge: Cambridge University Press, 2012), p. 2.

It was expected that reports from developed jurisdictions would refer to the influence of the OECD and, in fact, they did. Several reports from developed jurisdictions highlighted that the OECD transfer pricing guidelines are relevant when it comes to transfer pricing.[30] In some cases, branch reporters even pointed out that the BEPS project's outcomes included in the OECD transfer pricing guidelines would be immediately applicable in their jurisdiction without the enactment of any further domestic regulation.[31]

In these cases – where changes in the OECD transfer pricing guidelines are applicable immediately – the question arises of whether such changes will apply retroactively or only to future transactions. This issue was highlighted by the Austrian reporters, according to whom:

> "A relevant question would be whether the new guidance will apply only to transactions taking place after the implementation of the new OECD TPG [transfer pricing guidelines] (hence, by means of a 'static approach'), or rather retrospectively, to transactions started before this point in time (hence, with a 'dynamic approach'). The answer to this question will largely depend on whether the new OECD guidance is considered as including new concepts or as clarifying the concepts of the arm's length principle as included in section 6 paragraph 6 ITA. When analysing the outcome of the BEPS project relating to transfer pricing topics and considering unofficial discussions with members of the tax administration as well as recent developments in tax audits, the answer to this question seems to be going in the direction of a dynamic use of the new OECD TPG. Moreover, according to the Austrian TPG, domestic law will – in case of doubt – be interpreted in line with the current version of the OECD TPG. However, this approach could be criticized from a constitutional perspective."[32]

The reporters' position was that the Austrian authorities will most probably favour a "dynamic application" of the transfer pricing guidelines rather than a "static application".[33] The same position was supported in the Belgian,[34] Canadian,[35] Norwegian,[36] Spanish[37] and Swedish[38] reports. This issue was also included in the Mexican report. However, the branch reporter was less assertive when analysing the topic. In his words:

> "further analysis is required in order to determine whether the resulting guidelines from the BEPS project could be applied for interpreting the TP provisions

30 See reports from Australia, Denmark, France, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom and the United States.

31 See reports from Austria and Belgium.

32 See section 2.1 of the Austrian report (footnotes omitted in this and all subsequent citations from branch reports).

33 On the distinction between a "static" and "dynamic" interpretation, see Sergio André Rocha, *Interpretation of Double Taxation Conventions: General Theory and Brazilian Perspective* (The Netherlands: Kluwer, 2009), pp. 123–126.

34 See section 3 of the Belgian report.

35 See section 2.1 of the Canadian report.

36 See section 2.1 of the Norwegian report.

37 See section 2.1 of the Spanish report.

38 See section 2.2.3 of the Swedish report.

in previous years or could only be applied as of the date of approval by the OECD of such guidelines and beyond. Issues related with static and dynamic interpretation of the MITL [Mexican Income Tax Law] and the OECD TP guidelines should be analysed."[39]

These issues appeared in passing in other reports. It seems that there is a trend for changes in the OECD transfer pricing guidelines to be applied retroactively, as interpretative provisions.

However, this position must be taken with caution. As noted by the General Reporter in a previous work, "[i]n order that a treaty (as well as any other legal rule) may be classified as interpretative, it must remain entirely in the field of the framework of the rule interpreted, having as its purpose only the selection of one of the rules that may be created from the normative text".[40] Therefore, if the new transfer pricing guidelines significantly change transfer pricing standards, establishing obligations that could not be inferred from previous provisions, they should only be applied for the future.

It is interesting to note that the analysis of reports from developing countries[41] points in the same direction as that from developed jurisdictions' reports. In most cases, reference is made to the influence and relevance of the OECD transfer pricing guidelines.[42] In the Argentinian report, for instance, the OECD's influence is also a part of a larger government policy objective of joining the OECD.[43] The intention of becoming an OECD member is also highlighted in Peru's branch report.[44]

4.1. Divergent practice

One of the aims of the outline sent to branch reporters was to identify jurisdictions whose practices depart from the OECD standards. A review of the reports received indicates that very few reporters mentioned the existence of relevant divergent practices. In general, the OECD transfer pricing guidelines are the most relevant global standard for transfer pricing. In the following paragraphs these divergent practices are highlighted.

To prevent tax planning involving transfer pricing in commodity transactions, Argentina was the first to introduce the so-called "sixth method", which received this name "because it has been added to the existing five OECD-based TP methods provided for in Argentine domestic law. The sixth method aims to deter schemes in

39 See section 1 of the Mexican report.

40 Rocha, *op. cit*., p. 88.

41 The term "developing country" has an open interpretation. It includes jurisdictions with different levels of development and infrastructure. It is worth pointing out that in this report the expression "developing countries" includes all such jurisdictions, even those that are G20 members. For further analysis on this topic, see Paulo Rosenblatt, *General Anti-Avoidance Rules for Major Developing Countries* (The Netherlands: Kluwer, 2015), pp. 9–13. In this General Report, "developing countries" are those so categorized by the IMF's *Economic Outlook Report* of 2015. See IMF, *World Economic Outlook* (Washington: International Monetary Fund, 2015), p. 152.

42 See reports from Bolivia, Bulgaria, Chile, Colombia, Hungary, India, Korea, Ma-laysia, Mexico, Peru, Poland, Singapore, South Africa, Turkey, Ukraine, Uruguay and Venezuela. See

43 sections 2.4 and 2.6 of the Argentinian report.

44 See section 2.1 of the Peruvian report.

the commodity industry similar to those implemented by La Anglo, a subsidiary of a British MNE, in the early 1930s."[45] Specific transfer pricing methods applicable to transactions with commodities have been included in the BEPS report on Actions 8–10 (see section 9 below).

The most blatant case of divergent practice is found in Brazil. According to the Brazilian reporters:

> "Brazil does not follow the OECD's transfer pricing (TP) guidelines for multinational enterprises and tax administrations. Brazil is not a member of the OECD and is not bound to the application of the guidelines, either by means of international conventions, or by virtue of its domestic legislation."[46]

According to the Italian report, the jurisdiction's legislation and court decisions provide for a few deviations from the OECD's standards, regarding: (a) a safe harbour related to royalty transactions; (b) the application of a mark-up in cost-sharing related to intra-group services; and (c) the determination of costs in the field of online advertising and connected services.[47]

Per the Malaysian report, even though the jurisdiction's transfer pricing regulations are largely based on the OECD's standards, there are a few areas of difference, such as: (a) the definition of "control" is wider than the OECD meaning; (b) the Inland Revenue Board of Malaysia "has the tendency in most cases to apply the median without considering the use of other measures such as the mean, weighted averages, the interquartile range, etc."; and (c) "[p]rofit split methodology is rarely applied and in most cases, the tax authority moves back to the comparable uncontrolled price method or the transactional net margin method".[48]

The New Zealand report also includes a few distinctive features of this jurisdiction's transfer pricing regulations, as follows: (a) regarding low-value and non-core services, "[t]he Income Tax Act provides for the transfer of the burden of proof from the taxpayer to Inland Revenue to prove a 'more reliable measure of the arm's length amount'"; and (b) simplified methodologies exist for low-value and non-core services, as well as for low-value loans.[49]

According to the Peruvian report, there are also some "peculiarities" in this jurisdiction's transfer pricing regulations, such as: (a) "TP rules are applicable not only to international controlled transactions, but also to controlled domestic transactions and even to non-controlled tax haven transactions"; (b) "[i]t is mandatory to use interquartile ranges where there is more than one comparable observation"; (c) since 2013, Peru has introduced a version of the so-called "sixth method"; and (d) there are two versions of the profit split method.[50]

Poland's branch report pointed out some deviations from OECD standards, as follows:

[45] See section 4.1.1 of the Argentinian report.
[46] For a detailed analysis of Brazil's divergent practice, see section 1 of the Brazilian report.
[47] See section 1 of the Italian report.
[48] See section 1 of the Malaysian report.
[49] See section 1 of the report from New Zealand.
[50] See section 1 of the Peruvian report.

> "Major deviations between the OECD TP guidelines and Polish rules include a 5 per cent independence threshold (subject to change to 25 per cent as of 2017), a fragmented transaction-by-transaction TP approach with low transaction value thresholds subject to documentation, and a lack of requirement for economic comparable analyses as part of TP documentation. The extremely low 5 per cent independence threshold results in the qualification of counterparties as related entities even in cases of transactions undertaken between commercially independent businesses and publicly owned companies with low interest stakeholders. The 5 per cent threshold also has an impact on the application of independence criteria in searches for comparable companies – in practice its literal application results in the rejection of otherwise comparable entities and degrades the search results.
>
> A specific deviation from the OECD TP guidelines relates to the pricing of financial transactions – loans, guarantees and the like – which according to Polish TP regulations should be priced at the lowest interest/price applicable to comparable financial transactions. As a result, use of publicly available data and data requested from financial institutions both by taxpayers as well as by tax authorities during audits is still the predominant way for both the set up as well as the examination of such transactions."[51]

Portugal's report also mentioned the existence of small divergences between the jurisdiction's practices and the OECD standards. According to the report:

> "Although the Portuguese TP rules are closely based on the OECD standards, the Portuguese TA [tax authorities] launched, in 2014, some new rules regarding the tax deductibility of some types of costs, namely financial ones, which define a threshold above which those costs will not be tax deductible, even when they comply with the TP rules. This turns out to be the first deviation from the strict application of the arm's length principle in some specific situation where the TA has faced, through consistent litigation, difficulties in effectively applying the arm's length based approach."[52]

As previously noted, even though there are some references to divergent practices, overall, they seemed to be minor. In fact, it is worth pointing out that most of the jurisdictions whose reporters mentioned divergent practices stated that, in general, their transfer pricing regulations were aligned with OECD standards. The only branch that reported a significant departure from OECD practices was the Brazilian branch.

4.2. Summary

Considering the comments above, it is possible to state the following:

- The OECD transfer pricing guidelines are the most influential transfer pricing standard in the participating IFA branches.

[51] See section 1 of the Polish report.
[52] See section 1 of the Portuguese report.

- Even developing countries refer to the OECD standard as the basis for their transfer pricing, or as a secondary support document.
- Although a few branch reports make reference to divergent practices the only example of significantly divergent practice is the case of Brazil.

5. Effects of the BEPS project

It was noted in the previous section that the OECD transfer pricing guidelines are generally considered to be the most influential source of reference for domestic transfer pricing regulations. Assuming this to be true, it is interesting to inquire how jurisdictions reacted to the BEPS project's outcomes in this area. Accordingly, branch reporters were asked to comment on how such outcomes affected their jurisdiction's domestic transfer pricing policies and practices.

The position taken by the BEPS report on Actions 8–10 is that:

> "This Report contains revised guidance which responds to these issues and ensures that the transfer pricing rules secure outcomes that see operational profits allocated to the economic activities which generate them. It represents an agreement of the countries participating in the OECD/G20 BEPS Project. *For countries that formally subscribe to the Transfer Pricing Guidelines, the guidance in this Report takes the form of amendments to the Transfer Pricing Guidelines*. Therefore, this Report also reflects how the changes will be incorporated in those Guidelines" [emphasis added].[53]

Some branch reporters from developed jurisdictions communicated that the outcomes of the BEPS project in Actions 8–10 will be generally accepted without the need for changes in domestic provisions – even if, in some cases, as an interpretative tool or soft law.[54] However, that is not the case in many jurisdictions. For instance, in the case of Germany changes in domestic regulations will be required for the implementation of the BEPS outcomes related to transfer pricing.[55] The report from New Zealand mentions the relevance of the transfer pricing guidelines. However, as noted by the branch reporters, "New Zealand's TP provisions do not expressly incorporate the OECD TP guidelines ... in the event of any inconsistency between the legislative provisions and the guidelines, the legislative provisions (interpreted in the usual way) would prevail".

It is worth noting the Australian branch position: "[t]he most significant moves by Australia in addressing BEPS are the unilateral adoption of the MAAL [Multinational Anti-Avoidance Law]". Hence, for the Australian branch reporter, even though the "TP outcomes of the BEPS project have been generally accepted as positive and embraced by the Australian government and Australia's tax authority", the most relevant instrument enacted to combat BEPS is domestic.[56] Australia was

53 OECD, *op. cit.*, p. 10.
54 See reports from Austria, Belgium, Canada, Finland, Italy, Norway, Spain, Sweden and Switzerland.
55 See section 2.1 of the German report.
56 See section 2.1 of the Australian report.

the only jurisdiction that referred to a domestic initiative that was currently more relevant for transfer pricing purposes than the BEPS project itself.

Considering the scope of this section, it is interesting to analyse how reporters from developing jurisdictions commented on the effects of the BEPS project on their transfer pricing policies and practice. It is also pertinent to investigate whether these reporters indicated that their jurisdiction had had relevant participation in the discussions coordinated by the OECD.

Two developing countries' reports did not make any explicit reference to a direct influence of the BEPS project on their transfer pricing policies and practice, or to their jurisdiction's participation in the project.[57] Others mentioned their participation in the project and/or their intention to adopt, to some extent, its transfer pricing outcomes.[58] The Czech branch reporter commented that the modified transfer pricing guidelines should be applied directly.[59]

Brazil's position is singular, in line with the jurisdiction's distinctive approach to transfer pricing. The Brazilian branch reporters highlighted note 1 at the end of the report on Actions 8–10, according to which:

> "'Brazil provides for an approach in its domestic legislation that makes use of fixed margins derived from industry practices and considers this in line with the arm's length principle. Brazil will continue to apply this approach and will use the guidance in this report in this context. When Brazil's Tax Treaties contain Article 9, paragraph 1 of the OECD and UN Model Tax Conventions and a case of double taxation arises that is captured by this Treaty provision, Brazil will provide access to an MAP [mutual agreement procedure] in line with the minimum standard of Action 14.'"[60]

Per the reporters' view, this could be seen as a waiver from the OECD for the jurisdiction to continue adopting an independent approach to transfer pricing – as this note is linked to the paragraph transcribed above, according to which jurisdictions that adopt the transfer pricing guidelines should consider BEPS outcomes as changes to those guidelines – which could be read as "jurisdictions that *do not* adopt the transfer pricing guidelines *should not* consider the BEPS outcomes as changes to those guidelines".[61]

The Uruguayan reporters voiced a rather common criticism from developing jurisdictions: that the BEPS project was not conceived or developed taking into account the distinctions between developed and developing jurisdictions. According to them:

> "some academic opinion has expressed a more critical view on the matter. Blanco, in a presentation at the University of the Republic of Uruguay, argued that the political structure of taxation pursued by this plan has 'two significant

[57] See reports from Bolivia and Venezuela.
[58] See reports from Bulgaria, Colombia, Hungary, India, Korea, Mexico, Peru, Poland, Singapore, South Africa, Ukraine and Uruguay.
[59] See section 2 of the Czech report.
[60] OECD, *op. cit.*, p. 185. See section 2.1 of the Brazilian report.
[61] See note 53.

features: (a) the decrease of the autonomous decision making capacity of states in tax matters; and (b) the establishment of the OECD (and similar organizations) as the new centres of global fiscal power'. Mazz highlights that when the BEPS project proposes the unification of domestic rules and provisions stated in the conventions, it should consider the major economic and regulatory differences existing between members and non-members of the OECD."[62]

The reports from Finland, France, Korea and Norway referred to an aspect that was not mentioned in this section in most of the reports: the reaction from the business community to the transfer pricing BEPS project outcomes.

According to the Finnish reporters, the transfer pricing outcomes have:

"been widely criticized by some business stakeholders. There are two main arguments that have especially been mentioned. First, the status of a signed contract has met with strong criticism. Actions 8–10 state that factors other than a contract could also be determinative in pricing some transactions. This has been considered to open up too far-reaching opportunities for tax administrations to collect tax on the basis of almost anything that the tax administration claims to be at arm's length. Secondly, CbCR [country-by-country reporting] has met a highly critical reception from business due to the heavy compliance burden, as well as the confidentiality issues, it is bound to create. Some stakeholders fear that confidential information will be leaked publicly."[63]

The French branch report pointed out that "[t]he private sector approach consisted, in a nutshell, in a fear of an unfair implementation of the BEPS recommendations by tax auditors, knowing that the changes brought about by the OECD reports were major and that groups would have to adapt in the context of limited guidance". The French report also mentioned that "[r]epresentatives of the financial sector and insurance companies were worried about the fact that these recommendations did not provide guidance specifically applicable to these two particular sectors".[64]

After mentioning that the tax authorities, legislators and the academic community generally praised the BEPS outcomes, the Korean branch report stated that, "Korea's business sectors, however, are concerned about the overall effect that the domestic implementation of the BEPS Action Plan will produce in the future". This report raises an interesting fairness aspect related to the BEPS implementation: once you have changed the rules you have changed them for everybody. In the words of the Korean reporters:

"the position of Korean MNEs is that, although they have never been active, unlike their global counterparts, in taking advantage of the current international tax rules to gain leverage on tax avoidance strategies, they are unfairly obliged to sustain the hardships of compliance burdens and tax disputes, which will be likely to increase significantly as the implementation of the OECD's BEPS

[62] See section 3.1 of the Uruguayan report.
[63] See section 2.1 of the Finnish report.
[64] See section 3.1 of the French report.

project outcomes unfolds. Korean corporations are concerned that the rapidly expanding scope of information to be disclosed to tax authorities due to the BEPS project may infringe their rights to confidentiality. Further, they are afraid that BEPS-related measures, especially unilateral measures, which could be introduced by a number of countries, may give rise to double taxation and tax disputes, which would probably undermine their business competitiveness."[65]

Another report that mentioned the business community reaction was the Norwegian branch report. In its words:

"In general, the business community in Norway, including professional TP advisers, seems to understand and accept many of the changes suggested by the OECD in the BEPS project. In particular, the new documentation requirements following from BEPS Action 13 are not considered controversial. On the other hand, CbCR is seen by most companies as a burdensome obligation, where companies and advisers question the benefit of the report in its current form. Furthermore, there is a general perception that the emphasis on functional contribution and control over assets and risks may lead to subjective, incorrect and arbitrary allocations of profits that are not consistent with the arm's length principle. Clearly, some of the new guidance on intangibles, cost contribution arrangements (CCAs), risk and capital is perceived as a significant change to the current practice, and should not be applied retroactively. There is also a general consensus that the OECD seems to underestimate the value and risk attributable to capital. Furthermore, there is a general perception that the new OECD guidelines open the door for too much subjective interpretation by the tax authorities of what is a significant contribution. Hence, taxpayers fear that this may in some cases lead to more arbitrary and unreasonable reallocation of profits or losses, which again will lead to double taxation for taxpayers. It is also believed that the new guidelines will require more work by the taxpayer in terms of how transactions are structured, implemented, executed and documented. Accordingly, the new OECD TP guidelines will be more burdensome to apply in practice for the taxpayer than the current situation."[66]

The Swedish branch report voiced a different concern: that "[t]he BEPS project is likely to result in complex disputes given the focus on substance and important functions performed, as tax administrations in different jurisdictions could interpret the commercial reality underpinning TP policies differently." This could end up being a cause of double taxation.

This is an interesting point. As previously noted, the risk analysis proposed in the BEPS report on Actions 8–10 can be easily applied in extreme situations. However, there are a variety of cases where the allocation of functions and risks will prove to be troublesome, may trigger controversies and even result in double taxation. These two aspects, the potential to generate tax controversies and to bring about double taxation, will be addressed in another section of this General Report.

[65] See section 2.1 of the Korean report.

[66] See section 2.1 of the Norwegian report.

5.1. Summary

In view of these comments, it is possible to summarize the findings of this section as follows:

- Most jurisdictions – developed and developing – are committed to the adoption of the BEPS project outcomes – at least to some extent.
- There was an isolated commentary from Uruguay that raises concern about a jurisdiction's tax sovereignty and the role of the OECD as some sort of central tax power.
- Some branch reporters stated that the reaction to the BEPS project from the business community had not been as positive as the reactions from government, tax authorities and academia.

6. Challenges of transactions with intangibles

As previously mentioned, transactions with intangibles are at the core of many of the aggressive tax planning structures that triggered the BEPS project. It is therefore only natural that transactions with intangibles occupy a protagonist position in the OECD work on transfer pricing. Aspects related to the outcomes of Actions 8–10 on intangibles will be the focus of this section.

6.1. Definition of intangibles and transactions with intangibles

Many jurisdictions do not have a clear definition of intangibles. As noted by the OECD, definitions of intangibles that are either too broad or too narrow may generate transfer pricing problems.[67] One of the BEPS project's goals is to provide a clear and uniform definition.

It is one thing to define intangible assets, but it is another to identify transactions with intangibles. Reporters were invited to indicate whether there are any specific rules for the definition of transactions with intangibles in their jurisdiction – including identifying the legal owner of the assets and how they benefited each entity of the MNE group.

In general, it was apparent that, with very few exceptions,[68] most jurisdictions do not have a definition of intangible assets specifically for transfer pricing purposes.[69] In some cases, there were definitions that were established in regulations covering other areas – such as intellectual property or civil law – that might be used for transfer pricing. There are also jurisdictions that make reference to accounting principles as one of the elements that could be used to reach a definition of intangibles.[70] Some reporters highlighted that their jurisdiction would probably

[67] OECD, *op. cit.*, p. 67.

[68] See reports from Chinese Taipei, India, Malaysia, South Africa and the United States.

[69] See reports from Argentina, Australia, Austria, Bolivia, Bulgaria, Canada, Chile, Colombia, Denmark, Finland, France, Germany, Hungary, Japan, Korea, Luxembourg, the Netherlands, New Zealand, Norway, Peru, Poland, Portugal, Serbia, Singapore, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, Uruguay and Venezuela.

[70] See reports from Belgium, Brazil, Colombia, Italy and Portugal.

follow the amended OECD transfer pricing guidelines.[71] This position is supported by the European Union reporters, according to whom "in practice, in the TP area, the definition used should correspond overall to that proposed in the OECD TP guidelines".

Brazil's branch reporters commented on the distinctive approach of this jurisdiction to transactions with intangibles. In their words:

> "In practical terms, Brazilian legislation deals with the issue of transactions with intangibles by denying or significantly limiting the deduction of royalties and payments for technical, scientific, administrative or similar assistance. Even though this approach is a serious violation of taxpayers' rights (indeed unconstitutional), it could be seen as an effective means to combat BEPS."[72]

Most reports did not refer to the existence of explicit rules regarding transactions with intangibles,[73] with a few exceptions.[74] Other reports pointed out that the amended transfer pricing guidelines will be used as reference.[75]

It is worth highlighting the Belgian report, particularly the part that states:

> "Belgian legislation is based on civil law principles. This means that, for legal purposes, only the legal owner can exercise all rights related to an asset, whether tangible or intangible, unless some of those rights are transferred contractually to another party. Legally speaking, economic ownership is not recognized under civil law. Some rights related to an asset such as 'usufruct' (a sort of 'life interest') do not correspond to economic ownership."[76]

This analysis between the prevalence of form over substance – or vice versa – will be the focus of the following section.

6.2. Substance-over-form approach towards intangibles

Over time, a shift has occurred from a formalistic approach to transfer pricing – which would analyse transactions based on the formal contracts signed by the parties – to a more substance-over-form oriented approach.[77]

Transactions involving intangibles have been central to international tax planning. Many of the cases that have gained notoriety in recent years are related to the transfer of intangibles themselves or of the right to use them.

[71] See reports from Argentina, Austria, Chile, Denmark, New Zealand, Norway and the United Kingdom.

[72] See section 2.2.2 of the Brazilian report.

[73] See reports from Argentina, Australia, Austria, Bolivia, Bulgaria, Canada, Chile, Colombia, Denmark, Finland, France, Germany, Hungary, India, Italy, Korea, Luxembourg, the Netherlands, New Zealand, Norway, Peru, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, Uruguay and Venezuela.

[74] See reports from Bulgaria, Malaysia, South Africa and the United States.

[75] See reports from Argentina, Austria, Belgium, France, Italy and the United Kingdom.

[76] See section 2.2.2 of the report from Belgium.

[77] On this topic, see Rosenblatt, *op. cit.*, pp. 134–147.

This scenario has encouraged a "substance-over-form" approach towards transactions with intangibles, requiring an analysis beyond legal ownership. Therefore, entitlement to returns deriving from intangibles should also be based on a "substance-over-form" analysis. According to proposed changes to the OECD transfer pricing guidelines:

> "Although the legal owner of an intangible may receive the proceeds from exploitation of the intangible, other members of the legal owner's MNE group may have performed functions, used assets, or assumed risks that are expected to contribute to the value of the intangible. Members of the MNE group performing such functions, using such assets, and assuming such risks must be compensated for their contributions under the arm's length principle."[78]

The debate regarding the preference for substance over the legal form raises the issue of what exactly substance is. This aspect was mentioned by the Australian reporter. In his words, the lack of guidance regarding the meanings of "form" and "substance" "raises the following questions: does 'form' mean 'legal form' or something more akin to 'legal substance' or something else? Does 'substance' mean 'legal substance' or 'economic substance' or 'economic equivalence' or something else?"[79]

The substance-over-form approach supported by the BEPS project outcomes makes the analysis of the risks taken and the functions performed by the entity even more relevant. As noted by the Austrian reporters, the new guidance from the OECD is specifically concerned with "the analysis of functions related to development, enhancement, maintenance, protection and exploitation (DEMPE functions)".[80] According to the BEPS report on Actions 8–10:

> "In transfer pricing cases involving intangibles, the determination of the entity or entities within an MNE group which are ultimately entitled to share in the returns derived by the group from exploiting intangibles is crucial. A related issue is which entity or entities within the group should ultimately bear the costs, investments and other burdens associated with the development, enhancement, maintenance, protection and exploitation of intangibles. Although the legal owner of an intangible may receive the proceeds from exploitation of the intangible, other members of the legal owner's MNE group may have performed functions, used assets, or assumed risks that are expected to contribute to the value of the intangible. Members of the MNE group performing such functions, using such assets, and assuming such risks must be compensated for their contributions under the arm's length principle. This Section B confirms that the ultimate allocation of the returns derived by the MNE group from the exploitation of intangibles, and the ultimate allocation of costs and other burdens related to intangibles among members of the MNE group, is accomplished by compensating members of the MNE group for functions performed, assets

78 OECD, *op. cit.*, p. 73.
79 See section 2.2.3.2 of the Australian report.
80 See section 2.2.3 of the Austrian report.

> used, and risks assumed in the development, enhancement, maintenance, protection and exploitation of intangibles according to the principles described in Chapters I–III."[81]

In most cases, branch reporters observed that in their jurisdiction there were no specific substance-over-form provisions related to transfer pricing. However, many of them made reference to the application of domestic general substance-over-form provisions or practices in the field of transfer pricing.[82] In the case of Bulgaria, reference was made to explicit transfer pricing substance-over-form rules.[83]

In Chile, the formalistic approach still prevails, with the application of transfer pricing rules having as reference the contracts actually signed by the parties and the legal ownership of intangibles.[84] Argentina reported that even though the legal form prevailed, there were some cases where the tax authorities attempted to apply a substance-over-form approach.[85] A few jurisdictions mentioned that, although the legal form generally prevailed in the tax field, transfer pricing was an exception, with the tax authorities applying a substance-over-form approach.[86]

There are jurisdictions where the changes in the OECD transfer pricing guidelines in this area will probably become the standard.[87]

The German report presented an interesting observation highlighting the need for a clearer and more explicit substance-over-form provision as follows:

> "However, this general anti-abuse clause has not proved to be fully effective in the past, and from the perspective of the German tax authorities, implementation of the OECD/G20 recommendations requires an explicit 'substance-over-form' provision providing a clear statutory definition for a specific legal consequence. In the business community, however, there are serious reservations about introducing a provision of this kind since doubts exist about whether this is consistent with the arm's length principle. Moreover, agreement between the Federal Ministry of Finance and the *Länder* (federal state governments) has yet to be completed. The former regards the introduction of a specific substance-over-form provision as being necessary, in order for it to enable Germany to withstand or enforce claims *vis-à-vis* treaty partners. No decision has been made as yet in this area."[88]

Not surprisingly, Brazil's approach in this area is also distinct from that identified in all other jurisdictions. In the words of the branch reporters, "[t]he restrictive Brazilian legislation with respect to deductibility of expenses related to intangibles does not entail significant tax strategies that would demand a substance-over-form

81 OECD, *op. cit.*, pp. 73–74.
82 See reports from Austria, Bolivia, Chinese Taipei, Colombia, France, Hungary, Italy, Japan, Korea, the Netherlands, New Zealand, Norway, Peru, Poland, South Africa, Sweden, Turkey, Ukraine, the United Kingdom, the United States, Uruguay and Venezuela.
83 See section 2.2.3 of the Bulgarian report.
84 See section 2.1.3 of the Chilean report.
85 See section 2.3 of the Argentinian report.
86 See reports from Belgium, Canada and Malaysia.
87 See reports from Austria, Denmark, Norway, Portugal, Singapore and Spain.
88 See section 2.2.3 of the German report.

approach towards intangibles. Therefore, there is no example of such treatment in legislation or case law."[89]

6.3. Hard-to-value intangibles

The BEPS project has raised concerns regarding the valuation of hard-to-value intangibles. In fact, the valuation of intangibles *per se* poses several challenges due to problems in comparability.

According to the OECD:

> "When valuation of an intangible or rights in an intangible at the time of the transaction is highly uncertain, the question arises as to how arm's length pricing should be determined. The question should be resolved, both by taxpayers and tax administrations, by reference to what independent enterprises would have done in comparable circumstances to take account of the valuation uncertainty in the pricing of the transaction."[90]

Oleh Fedusiv has commented on the outcome of the OECD's work in this area. In his words:

> "Action 8 equips tax administrations with a special tool to examine transfer prices set in relation to the transfer or the use of HTVIs, namely *ex post* assessment. The rationale behind this approach is that tax authorities suffer from information asymmetry when assessing transfer prices in HTVI transactions. They may not have 'specialized knowledge, expertise and insight into the business environment in which the intangible is developed or exploited'. The OECD argues that tax authorities are, as a rule, dependent on information provided by taxpayers – which makes it difficult for them to reliably examine relevant transfer prices."[91]

The analysis of the branch reports in this area showed that most jurisdictions do not have any specific provisions or established practices dealing with hard-to-value intangibles. Moreover, in most cases no reference has been made to changes as a result of the BEPS report on Actions 8–10. A few branch reporters commented specifically on their experience in this area.[92]

6.4. Cost contribution agreements (CCAs)

CCAs are agreements "among business enterprises to share the contributions and risks involved in the joint development, production or the obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangible assets or services are expected to create direct benefits for the businesses of each of the participants".[93]

[89] See section 2.2.3 of the Brazilian report.
[90] OECD, *op. cit.*, p. 107.
[91] Oleh Fedusiv, "Transactions with Hard-to-Value Intangibles: Is BEPS Action 8 Based on the Arm's Length Principle?" (2016) 23(6) *International Transfer Pricing Journal*, p. 484.
[92] See reports from Belgium, Canada, India, the Netherlands, Portugal and the United States.
[93] OECD, *op. cit.*, p. 161.

CCAs can be a source of BEPS if contributions and benefits to the participant companies are not properly determined. According to the Finnish report:

> "In some countries CCAs have created significant BEPS issues in cases where intangibles were contractually moved between group members without arm's length compensation. CCAs have sometimes included elements where the compensation for contributing existing intangibles that were part of the arrangement has been more or less nominal compared to the pricing of the comparable intangible in a transaction between unrelated parties."[94]

The post-BEPS approach to CCAs – in line with other BEPS recommendations – puts risk at the heart of transfer pricing analysis.[95] As noted by the Hungarian report:

> "According to the BEPS approach, CCAs continue to be evaluated based on the substance of the arrangement rather than the contractual form. The requirement that all CCA participants must have a clearly defined interest in the CCA output remains unchanged as well; however, under the BEPS project all CCA parties must also have the ability to exercise control over the risks and must also have the financial capacity to assume those risks."[96]

From the analysis of the branch reports it is possible to single out the usual features of CCAs as follows:

- the existence of a written agreement;
- a mutual and common interest shared by the participating entities;
- the existence of mutual benefits to the participating companies;
- contributions being proportionate to the benefits;
- reasonable and determinate allocation keys; and
- core activities cannot be their object.

In general, jurisdictions did not report changes in connection with the BEPS-related CCA measures.

6.5. Comparability and group synergies

In the words of Marta Pankiv:

> "For transfer pricing analysis, it is critical to understand the MNE's global business by identifying all factors that contribute to value creation, including the risks assumed by each member, specific market characteristics, location, business strategies and MNE group synergies. The group synergies that can be attributed to 'deliberate concerted group actions' should generally be shared between the members of the group in proportion to their contribution to the creation of the synergy."[97]

[94] See section 2.2.6 of the Finnish report.
[95] See section 2.2.6 of the Spanish report.
[96] See section 2.2.6 of the Hungarian report.
[97] Marta Pankiv, "Post-BEPS Application of the Arm's Length Principle to Intangibles Structures" (2016) 23(6) *International Transfer Pricing Journal*, p. 463.

According to the BEPS report on Actions 8–10, "in some circumstances, MNE groups and the associated enterprises that comprise such groups may benefit from interactions or synergies amongst group members that would not generally be available to similarly situated independent enterprises".[98] On the other hand, as pointed out in the Hungarian report, "Negative effects can also arise, such as increased bureaucracy or ineffective IT systems."[99]

Belgium's branch report mentions that this jurisdiction was performing group synergy analysis before the BEPS report on Actions 8–10. According to the branch reporter, "Synergies were explicitly recognized by the tax authorities before the BEPS report, particularly by the Ruling Commission. From a TP perspective, synergies mean advantages stemming from the fact that a company belongs to a group and can benefit from advantages that an independent company would not obtain."[100] The reporter further described how the Belgium analysis works, as follows:

> "Synergies have also been recognized in Belgium through the so-called 'excess profit rulings'. These rulings are delivered by virtue of article 185(2) of the ITC, which deals with cross-border transactions of companies or branches belonging to an MNE. This article provides a downward adjustment: when a company is taxable on profits on which another company could be taxed or has already been taxed, the taxable income of the first company is adjusted in an appropriate manner, as if the agreed conditions between the two companies were those which would have been agreed between two independent companies.
>
> Because a Belgian company benefits from synergies and other intangibles (a client list, a distribution network, etc.) for which it does not pay any consideration, it will generate additional profits stemming from those 'received' intangibles. Because an independent company would not benefit from those intangibles and in order to respect the arm's length principle, the Belgian entity requests, in an advance ruling, the tax exemption of the portion of the profit stemming from the exploitation of those 'received' intangibles."

Canada also has experience with group synergy analysis. According to this branch report:

> "One significant implication of this prevailing approach arises in the context of large group pricing. That is, on the approach taken by the courts in *General Electric Capital Canada Inc.* and *GlaxoSmithKline Inc.*, that the ability of a group to obtain more favourable prices when acting in concert should arguably be taken into account when determining the arm's length price of fees paid to a central procurement entity."

98 OECD, *op. cit.*, p. 47.

99 See section 2.2.4 of the Hungarian report. A similar position is found in the branch report from the United States. According to the branch reporters: "Group synergies refer to the favourable (or disadvantageous) influences that may arise from being part of the enterprise as a whole. For example, a larger company may benefit from bulk purchase discounts (as compared to a smaller sized company). In general, under US rules, group synergies are comparability factors." See section 2.2.4.2 of the report from the United States.

100 See section 2.2.4 of the report from Belgium.

The French report also mentioned that:

> "French tax auditors have been active in the analysis of the integration of entities within a group, and the benefit the whole group may be able to gain from such integration. Once again, there is no specific law or tax administration regulation connected to this approach. However, tax auditors have developed a common understanding and are able to apply consistent argumentation."[101]

It is interesting to highlight Japan's position, which is in clear opposition to the use of group synergies in the context of transfer pricing. In the words of the branch reporter: "Japan still has a negative attitude to the introduction of the notion of 'group synergies' into the TP guidelines. The Japanese perspective is that the notion of 'intangibles' is restricted to only that which can be held or controlled. Thus, group synergies of MNEs do not fall within the scope of the TP rules."[102]

However, many jurisdictions mentioned that they do not have any rules or experience with considering group synergies in the context of applying transfer pricing rules.[103]

6.6. Summary

Taking the previous comments into account, we can summarize as follows:

- Most branches reported that their jurisdiction did not have specific rules for defining intangibles or transactions with intangibles.
- Similarly, most branch reporters commented that their jurisdiction applied a substance-over-form approach to transfer pricing – even though very few have specific rules on the matter. Even jurisdictions that are generally formalistic make an exception for transfer pricing.
- Across the board, there have been no significant developments in the fields of hard-to-value intangibles and CCAs.
- Some jurisdictions mentioned their experience with group synergy analysis. However, there have been no significant advances in this area.

7. Low value-adding services

The provision of intra-group services is part of the operations of any MNE. As pointed out by the OECD, "Nearly every MNE group must arrange for a wide scope of services to be available to its members, in particular administrative, technical, financial and commercial services. Such services may include management, coordination and control functions for the whole group."[104]

[101] See section 3.2.4 of the French report.

[102] See section 2.2.4 of the Japanese report.

[103] See reports from Argentina, Bolivia, Brazil, Bulgaria, Chile, Colombia, Denmark, Germany, Korea, Luxembourg, Malaysia, Poland, Portugal, Singapore, Sweden, Ukraine, Uruguay and Venezuela.

[104] OECD, *op. cit.*, p. 143.

However, while quite common, the provision of intra-group services may open up BEPS opportunities for MNEs, which (to some extent) can be avoided through the application of transfer pricing rules.

According to the BEPS report on Actions 8–10, "there are two issues in the analysis of transfer pricing for intra-group services. One issue is whether intra-group services have in fact been provided. The other issue is what the intra-group charge for such services for tax purposes should be in accordance with the arm's length principle."[105]

This topic is interesting, since the OECD has proposed a simplified approach to deal with transfer pricing and low value-adding services. The proposed fixed margin – 5 per cent mark-up – deviates from the arm's length principle as traditionally supported by the OECD. As noted by Guglielmo Maisto:

> "Paragraph 7.61 provides for a profit markup equal to 5% to be applied to all pool costs. It is doubtful if one margin for all costs will properly reflect the arm's length remuneration. Accounting services may carry profit margins which are different from markups on monitoring safety and environmental matters. Furthermore, the flat markup disregards the location of the cost centre and the different labour cost levels which may be found in different countries. Group synergies leading to cost efficiency are also not taken into account (knowledge of business models within the group may result in lower cost compared to an arm's length situation)."[106]

For the purposes of the simplified approach, the BEPS report on Actions 8–10 provides the following definition:

> "7.45 Low value-adding intra-group services for the purposes of the simplified approach are services performed by one member or more than one member of an MNE group on behalf of one or more other group members which
> - are of a supportive nature;
> - are not part of the core business of the MNE group (i.e. not creating the profit-earning activities or contributing to economically significant activities of the MNE group);
> - do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles; and
> - do not involve the assumption or control of substantial or significant risk by the service provider and do not give rise to the creation of significant risk for the service provider."[107]

Since this simplified, fixed rate approach deviates from the traditional arm's length principle, it is interesting to analyse how jurisdictions are reacting to this alternative.

The Australian report indicated that:

> "The Australian Treasury is of the view that the adoption of the elective, simplified approach is 'likely to free up resources for tax administrators in ident-

[105] *Ibid*., p. 144.

[106] Guglielmo Maisto, "Transfer Pricing Aspects of Low Value-Adding Services", in Michael Lang *et al*. (eds.), *Transfer Pricing in a Post-BEPS World* (The Netherlands: Kluwer, 2016), p. 154.

[107] OECD, *op. cit*., p. 153.

> ifying and examining cross border dealings with significant TP and BEPS risks'. However, currently Australia's legislative provisions do not contain an election option in either section 815-125 or section 815-130 ITAA 1997. As such, it is unclear how taxpayers could elect to adopt the simplified approach in the amended OECD TP guidelines without specific legislative provision to do so."[108]

Other branch reporters also mentioned that their jurisdiction might come to accept the simplified methodology.[109] The report from Denmark commented that the jurisdiction had already included the simplified methodology in its guideline.[110]

Jurisdictions such as Belgium, which already have as policy requiring a profit margin on intra-group services,[111] are uncertain regarding whether the simplified approach will be adopted,[112] even though the Belgian report highlights that, "[t]his new regime will be welcome by companies as it will simplify the TP policy and documentation requirements".[113] Norway's branch report indicated that this jurisdiction would probably not follow the new OECD alternative approach. The South African report pointed out that the jurisdiction's tax authorities had already indicated that they would not apply the new simplified approach.[114]

The United States has traditionally applied a "no mark-up policy" to intra-group services. According to this jurisdiction's branch report:

> "The regulations make the SCM [services cost method] permanent. The SCM allows certain services to be priced at cost, that is, it permits the services to be reimbursed at cost, without a mark-up. To qualify for the SCM, the service must: (a) be a 'covered service'; (b) not be an 'excluded activity'; (c) satisfy the business judgment rule; and (d) maintain adequate books and records. To apply the SCM, under the business judgment rule, the taxpayer must reasonably conclude that, in its business judgment, the service 'does not contribute significantly to key competitive advantages, core capabilities, or fundamental risks of success or failure in one or more trades or businesses of the controlled group'."[115]

The US report did not indicate any change in the direction of levying a mark-up on intra-group services.

7.1. Summary

Considering the comments above, a summary of this section is that jurisdictions may move in the direction of applying a simplified, fixed margin methodology in

108 See section 2.4.2 of the Australian report.
109 See reports from Austria, Chinese Taipei, France, Hungary, Luxembourg, New Zealand, Poland, Portugal, Singapore, Sweden, Ukraine and the United Kingdom.
110 See section 2.4.2 of the Danish report.
111 This is also the case of Bulgaria, Italy and New Zealand.
112 This is also the case of Canada, Korea, Malaysia, Mexico and the Netherlands.
113 See section 2.4.2 of the Belgian report.
114 See section 2.4.2 of the South African report.
115 See section 2.4.2.3 of the US report.

this case. However, there is no indication that this fact could lead to the application of simplified methodologies in other areas.

8. Risk and capital

As previously mentioned, BEPS actions regarding transfer pricing are still based on the arm's length principle. On the other hand, the allocation of the fair share of tax to each jurisdiction where an MNE operates is one of the major goals of the project.

Action 9 of the BEPS project aimed at "adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital".[116]

In the 2013 OECD Secretary-General's Report to the G20 finance ministers and central bank governors, it was stated that:

> "In particular, the current interpretation of the arm's length principle is challenged by the ability of MNEs to artificially shift profits by transferring easily movable assets (such as intangibles and capital). The action plan will fix these issues with measures, either within or beyond the arm's length principle, to ensure that taxable profits can no longer be artificially shifted away from the countries where value is created."

This goal reinforces the close connection between the application of the arm's length principle and the analysis of the functions and risks undertaken by the entities. According to the BEPS report on Actions 8–10, "in transactions between two independent enterprises, compensation usually will reflect the functions that each enterprise performs (taking into account assets used and risks assumed)".[117] Furthermore, "a functional analysis is incomplete unless the material risks assumed by each party have been identified and considered since the actual assumption of risks would influence the prices and other conditions of transactions between the associated enterprises".[118]

This means one more step towards putting the formal agreements signed by the parties in second place and determining the arm's length price based on the business and economic factors of the transaction carried out by the parties. Belgium's branch reporter supported the same view, as follows:

> "Since the tax authorities apply the OECD TP guidelines as they are modified over time, it is to be expected that they will apply the new OECD approach, which aligns returns with value creation and which comprises measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. As requested by the OECD, it is to be expected that the authorities will put less emphasis on the con-

116 OECD, *op. cit.*, p. 13.
117 *Ibid.*, p. 20.
118 *Ibid.*, p. 21.

> tractual arrangements where the actual behaviour of the related parties deviates from those contractual arrangements, and if the legal owner of the assets does not carry out the important functions, assume the most significant risks and enhance the value of its assets."[119]

Some branch reporters mentioned that their jurisdiction had not implemented any sort of risk analysis or was not focused on determining the compatibility between benefits received and capital employed.[120]

On the other hand, there are jurisdictions like Australia where the tax authorities' position is that:

> "TP analysis should look at the substance of transactions which is achieved by delineating between the entity which bears the risk of the transaction and the entity which derives the actual economic value of the transaction. The Treasury suggests that amendments to the 2010 OECD TP guidelines provide an approach which is consistent with how the ATO currently applies the Australian TP rules. That is, any TP analysis is based on an accurate delineation of what the associated enterprises actually contribute rather than contractual arrangements which may not reflect economic reality."[121]

Functional and risk analysis are also a reality in other jurisdictions.[122]

New Zealand's branch report singled out that this approach of functional and risk analysis would depend on the application of the jurisdiction's general anti-abuse rule. In the words of the reporters:

> "Under current New Zealand law it could only be through application of the GAAR, and the associated powers of reconstruction, that Inland Revenue could attempt to ensure that inappropriate returns do not accrue to entities solely because of contractually assumed risks or the provision of capital. Otherwise (and as described above) Inland Revenue must apply the TP provisions based on the legal arrangements actually entered into, even if those arrangements are motivated or structured to shift profits."[123]

Therefore legislative changes would be required in this jurisdiction for it to apply the suggested functional and risk analysis.

The Austrian branch report raised an interesting point, in that it refers to the fact that it is important to analyse the "role of capital in the future", as it "now appears clear that taxpayers should consider not only issues related to thin capitalization, but also the question of whether a company is overcapitalized".[124]

119 See section 2.3 of the Belgian report. Also see section 2.3 of the Finnish report.
120 See reports from Argentina, Brazil, Canada, Colombia, Italy, Japan, Ukraine and Venezuela.
121 See section 2.3 of the Australian report.
122 See the reports from Bolivia, Bulgaria, Chile, France, Hungary, India, Luxembourg, Mexico, the Netherlands and the United States.
123 See section 2.3 of the report from New Zealand. The same appears to be the case in Peru (see section 2.3 of the Peruvian report).
124 See section 2.3 of the Austrian report.

Another relevant aspect was pointed out in the Norwegian report related to how functions and risks are determined in certain areas. In the opinion of the reporter:

> "the ramifications of the new guidelines for the allocation of returns to risk and capital as described by the OECD in the BEPS Actions 8–10 report may have severe impacts on how returns are currently allocated within a group. In particular, groups where a significant part of the group's returns are attributed to asset owning companies, such as IP, shipping and rig companies, will probably be scrutinized in the years to come. If such asset owning companies are not able to demonstrate sufficient functional and financial capacity to effectively manage those assets and associated risks, it can be assumed that the tax authorities will try to reallocate profits to other companies within the group where the assets and associated risks are actually managed according to the tax authorities. This will be very relevant in Norway, which has a large offshore and shipping industry, where typically the vessels are owned by asset owning companies in low-tax jurisdictions or the Norwegian tonnage tax regime, and where the management company is located in Norway and taxed under the normal tax regime. In the light of this, it may be expected that companies will have to look at how they are currently operating the business and managing the assets and associated risks. Accordingly, it is safe to assume that the new guidelines on attribution of profits to risk and capital will have a significant impact on tax practice in Norway."

This point goes back to Sébastien Gonnet's critique (see note 24). Indeed, the risk analysis is very appropriate – and provides clearer results – for extreme cases, where income is attributed to entities that bear no risk and earn a large portion of the MNE's global income. However, in most cases the analysis will not be so simple. The outcome of this situation might be an increase in double taxation and transfer pricing litigation – which, by the way, seems to be a trend of post-BEPS transfer pricing. This same position was taken by the UK reporters, according to whom, "[t]he complexities around business risks and the link with the provision of capital mean that this is an area which is likely to be the subject of disputes between business and tax authorities – and between tax authorities – in the short term".[125]

Another branch report that highlighted the difficulties in applying the new OECD approach was the Uruguayan report. However, these branch reporters also pointed out another aspect: the risk of tax revenues ending up being shifted from developing to developed jurisdictions. It is worth quoting their words:

> "While the proposition put forward by these actions may be worthy of consideration in theory, in practice it will be an extremely complex and subjective task, not only because of the difficulty of identifying risks (non-tangibles) and measuring their level (full, medium or limited), but because for the arm's length principle to be effective such risks must be identifiable and measured equally in potential comparables. It is extremely difficult to determine the level of risk assumed by independent parties in view of the scant information that can be accessed publicly.

[125] See section 2.3 of the UK report.

> The position taken by these actions – if not interpreted in the proper way – runs the risk of strengthening the old claim of the developed jurisdictions of allocating income to the headquarters company, which – ultimately – will always end up making the decisions, to a greater or lesser extent. In the reporters' view, the notion of risk should therefore be interpreted very carefully by developing jurisdictions, if they do not want the income genuinely generated in their territories to migrate to developed countries."[126]

8.1. Summary

To wrap up this section, this General Reporter considers that even though a substance-over-form approach is part of the future of transfer pricing, there has not been a massive turn in the direction of functional and risk analysis. This is the case even though it seems that the general acceptance of the OECD transfer pricing guidelines as the transfer pricing standard will probably lead to a shift in this direction.

9. CUP and quoted prices for commodity transactions

As previously mentioned, the so-called "sixth method" was created by Argentina in 2003. As discussed in the Argentinian branch report, "it was targeted at the commodity industry because of the government's perception that this industry was involved in aggressive international transfer pricing manipulation based on a report by the tax authority". The Argentinian branch reporter mentioned that in its first decade of implementation the "sixth method" led to significant transfer pricing litigation between taxpayers and tax authorities.[127]

This situation was described by the Brazilian branch reporters:

> "Following the experience of Argentina, which created a specific method aiming at avoiding the use of traders in the export transactions of certain commodities, many countries, such as Uruguay, Ecuador, Mexico, Peru, Guatemala, Honduras, Dominican Republic, Ukraine and Brazil, also enacted variations of the sixth method. Although these methods are usually referred to under the same denomination, each jurisdiction's domestic legislation has its own peculiarities.
>
> The sixth method in those jurisdictions has a common aspect its applicability to export or import transactions of commodities between controlled parties in which there is a trader involved or for which there is a comparable price internationally quoted by a transparent market. The sixth method can be described as a variation of the CUP method, through which the transaction price is determined taking into account not the circumstances of the operation, but quotations from stock exchanges."[128]

[126] See section 3.3 of the Uruguayan report.
[127] See section 4.1.2 of the Argentinian report.
[128] See section 2.4.1 of the Brazilian report.

According to its branch report, Bolivia implemented a "sixth method", called "Argentino" in its regulations, in reference to its creation by Argentina. However, the Bolivian branch reporter pointed out that there are still many blank spots regarding its application.[129] Brazil also created a "sixth method", which was explained at length by the branch reporters.[130] India also has rules specific for transfer pricing and commodities, as does Peru. According to the Peruvian branch reporters, cross-border transactions with commodities between related parties became a focus of the Peruvian tax authorities, which led to the introduction, in 2012, of the new rules. In their words, the "new piece of legislation became informally known as the 'sixth method', since it was inspired by a trend which started in Argentina, where the rules were in the sixth paragraph of the relevant law, and then spread all over Latin America".[131] Uruguay also has a specific methodology for commodities, which is viewed as the adoption of the "comparable uncontrolled price method together with a special anti-evasion measure".[132]

Some commodity-exporting jurisdictions did not implement any specific transfer pricing method for commodities. This is the case of Australia. Per the Australian report:

> "The new OECD guidance relating to deeming the pricing date for commodity transactions when the taxpayer does not provide reliable evidence of the agreed pricing date may not be consistent with Australia's domestic TP rules. If the pricing date for commodity transactions is unknown, it seems likely that the reconstruction provision in subsection 815-130(3) would need to be applied to establish the date that independent enterprises might reasonably have agreed to."[133]

Many jurisdictions do not have any specific provisions relating to transfer pricing in transactions with commodities similar to the "sixth method" – generally applying the CUP method. And their branch reporters did not make reference to any intention to adopt regulations to this end.[134] The Italian report also pointed out that the CUP will continue to be the "go to" method for commodities. However, the branch reporter highlighted that changes in the OECD transfer pricing guidelines will be applicable in Italy.[135] Norway does not have specific transfer pricing rules for commodity transactions – even though this jurisdiction has some specific regulations regarding the determination of the price of oil.[136] The report from the European Union highlighted that "although several EU Member States apply specific transfer pricing legislation to commodity transactions, the most recent being Romania (2016), the topic has so far not been considered as part of coordinated works at EU level".[137]

[129] See section 2.4.1 of the Bolivian report.
[130] See section 2.4.1 of the Brazilian report.
[131] See section 2.4.1 of the Peruvian report.
[132] See section 3.4.1 of the Uruguayan report.
[133] See section 2.4.1 of the Australian report.
[134] See reports from Bulgaria, Canada, Chile, Chinese Taipei, Denmark, Finland, Hungary, Japan, Luxembourg, Malaysia, Mexico, the Netherlands, New Zealand, Portugal, Serbia, Sweden, Switzerland and Ukraine.
[135] See section 2.4.1 of the Italian report.
[136] See section 2.4.1 of the Norwegian report.
[137] See section 2.3.1 of the report from the EU.

9.1. Summary

Only a few commodity-exporting jurisdictions have enacted the "sixth method" – mostly Latin American jurisdictions. Most jurisdictions use the CUP as the applicable transfer pricing methodology for transactions with commodities.

10. Profit split in the context of value chains

Vikram Chand and Sagar Wagh analysed the general concept of the profit split method and how it differs from the formulary apportionment methodology as follows:

> "The profit split method is one of the transactional profit methods and the only two-sided method provided by the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines). This method aims at splitting the combined profits (or losses) arising from controlled transactions between associated enterprises on an economically valid basis, that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length. It is important that the profit split method not be confused with the non-arm's length approach of profit allocation, namely the global formulary apportionment method. This is because, when applying the profit split method, the division of profits arising from the controlled transactions between associated enterprises is based on a scientific analysis, while in case of the non-arm's length approaches, the division of profits arising from a controlled transaction is based on a pre-determined formula."[138]

In a recent article, Raffaele Petruzzi and Claire (Xue) Peng mentioned that:

> "Despite being one of the five OECD authorized transfer pricing methods, the profit split method is slightly different from the other methods. First, the profit split method is a two-sided method: it requires a consideration of both sides (goods seller and goods purchaser, or service provider and service recipient) of the controlled transaction to assess the relative contributions of each party. … Second, the profit split method is a profit-based method. It begins with calculating the combined profits of a transaction which are subsequently subject to a division through the arm's length principle."[139]

Several jurisdictions that use the OECD transfer pricing guidelines as a basis for domestic transfer pricing rules have the profit split method as one of their viable

[138] Vikram Chand and Sagar Wagh, "The Profit Split Method: Status Quo and Outlook in Light of the BEPS Action Plan" (2014) 21(6) *International Transfer Pricing Journal*, p. 402.

[139] Raffaele Petruzzi and Claire (Xue) Peng, "The Profit Split Method: Historical Evolution and BEPS Insights" (2017) 1 *Transfer Pricing International*, p. 44.

methods for transfer pricing control. Therefore, as pointed out by the Portuguese branch report, "[i]f it is demonstrated that it constitutes the best method based on the facts and circumstances, then the profit split method is allowed to be considered under the Portuguese TP rules".[140]

However, the analysis of the branch reports showed that there was a great deal of mistrust in relation to profit split.

According to the French report, "experience shows that tax auditors may not always be keen to use the profit split method, as the way some groups implement that method may be complicated, with no detailed information about the keys they use and no clear explanation of the link between these keys and the activities performed or the profit to share".[141]

In Germany, the profit split method can be used only if other methods cannot reasonably be applied. As stated in the branch report:

> "Use of the transaction profit split method has the explicit acceptance of the tax authorities, but due to a statutorily determined order of application, it can only be employed where the standard methods cannot or cannot reliably be used in the absence of unequivocally comparable arm's length prices (section 1(3) FTC)."[142]

Australia[143] and Spain[144] take the same position.

The risk of poor harmonization among jurisdictions in the application of profit split methodologies is highlighted in the UK report.[145] According to the branch reporters:

> "While profit split may be the most appropriate method depending on the facts and circumstances of the case (and particularly in cases involving the development of valuable intangibles) the practical difficulties of implementing and managing a profit split should not be underestimated. This is particularly the case when multiple countries are involved, due to the timing of local country audits and the potential consequential adjustments required in other participating countries."

In line with the UK position, the Swedish report also observed that the application of the profit split method requires a great deal of harmonization and that in the absence of such a harmonized approach the outcome could be double taxation. According to this jurisdiction's report, "[b]oth the Swedish TP network and the STA see a challenge in the practical and uniform implementation and interpretation at a worldwide level of profit (or loss) splits by tax administrations and companies, where different approaches would lead to an increased risk of disputes and double taxation".[146]

[140] See section 2.4.3 of the Portuguese report.
[141] See section 3.4.3 of the French report.
[142] See section 2.4.3 of the German report.
[143] See section 2.4.3 of the Australian report.
[144] See section 2.4.3 of the Spanish report.
[145] See section 2.4.3 of the UK report.
[146] See section 2.4.3 of the Swedish report.

South Africa's report suggested that subjectivity is a downside of profit split. Per this report:

> "With reference to the profit split method, the SARS [South African Revenue Service] highlights the subjectivity surrounding the allocation of profits as a key weakness of the method and goes further to state that it could result in a less reliable measure of the arm's length price than an analysis under one of the other methods. Although the exact facts and circumstances surrounding each case would determine which method was most suited to arriving at the arm's length result, this implied hierarchy would indicate that the SARS would not advocate the use of the profit split method as the default mechanism of first resort."[147]

Some branches reported that their jurisdiction had no position in relation to the profit split method.[148] Austria and Hungary stated that they have no profit split provisions but tend to follow the OECD.

The reports from Chile, India and Peru mentioned that the profit split method is possible in these jurisdictions but has never been used. The Colombian report also referred to the rare use of the method. The Finnish report went in the same direction, mentioning that there is very little case law about the issue.

Few jurisdictions reported a more consistent use of the profit split method.[149] Canada and Japan are waiting for the OECD to finish its work on this topic.

10.1. Summary

In reviewing the branch reports, it is possible to state that, even though the use of the profit split methd is possible in several jurisdictions, there are actually only a few that use the method customarily. On the other hand, there is a perception that the increase in the use of the profit split will also increase litigation and potentially the incidence of double taxation.

11. Transfer pricing documentation

The great majority of the jurisdictions surveyed indicated that they have either implemented or will implement country-by-country reporting requirements.[150] On the other hand, only a few branch reporters stated that their jurisdiction might not implement it at all.[151]

[147] See section 2.4.3 of the South African report.

[148] See reports from Argentina, Bolivia, Brazil, Korea, New Zealand and Turkey.

[149] See reports from Belgium, Bulgaria, Denmark, Poland and Singapore.

[150] See reports from Argentina, Australia, Austria, Belgium, Brazil, Canada, Chile, Chinese Taipei, Colombia, Denmark, Finland, Germany, Hungary, India, Italy, Japan, Korea, Luxembourg, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Peru, Poland, Portugal,Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, Ukraine, the United Kingdom, the United States and Uruguay.

[151] See reports from Bolivia, Bulgaria, Hungary and Venezuela.

Regarding the master and local files, the majority of the jurisdictions have also already implemented them, will implement them or have domestic rules that are equivalent to them, rendering new rules unnecessary.[152] A few branch reports mentioned that there was no indication that these transfer pricing documentation obligations would be created.[153]

The Brazilian branch reporters questioned the compatibility of country-by-country reporting with Brazil's National Tax Code provisions. In their words:

> "It is doubtful whether the ancillary obligations under CbCR are compatible with the Brazilian National Tax Code. According to the Code, ancillary obligations should be within the scope of tax collection or tax auditing (article 113, paragraph 2). The obligations pursuant to CbCR are not aimed at tax collection or tax auditing, but at collecting data for the purposes of economic and statistical analysis.
>
> The National Tax Code sets forth limits for the enactment of tax legislation. Article 113 allows the tax administration to create additional obligations for taxpayers, provided that they are relevant to the auditing and collection of taxes. The power to institute fines and penalties can only be exercised within this scope.
>
> However, CbCR demands a power which is not immediately within the scope of the provision, as traditionally conceived. The proposal does not aim at creating obligations in the interest of tax auditing and tax collection, but transfers part of the burden of gathering information relevant for the purposes of tax policy from the tax authorities to the taxpayers.
>
> It is not immediately obvious whether such a measure could be enforced by means of fines and penalties under the Brazilian National Tax Code – and, as a consequence, whether this measure could be, in fact, enforced under that Code. However, a broadened interpretation of the term 'in the interest of tax auditing and tax collection' could be sufficient to comprise measures similar to those set forth by CbCR, provided that the tax administration does not have access to the relevant information by other means. It is relevant to note that article 113 also limits the ability of tax authorities to redundantly require information to which they already have access by other means."[154]

The report from Denmark made an interesting point correlating country-by-country reporting with formulary apportionment. According to the Danish report:

> "Moreover, the Danish tax authorities have explicitly stated that the country-by-country report should not be applied as a substitute for core TP analyses, including whether a Danish entity has applied the arm's length principle on its intercompany transactions.

[152] See reports from Argentina, Australia, Austria, Belgium, Bolivia, Chile, Chinese Taipei, Colombia, Denmark, Finland, Germany, India, Italy, Japan, Korea, Luxembourg, Malaysia, Mexico, the Netherlands, New Zealand, Norway, Peru, Poland, Portugal, Singapore, South Africa, Spain, Sweden, Turkey, Ukraine, the United Kingdom and Uruguay.

[153] See reports from Brazil, Bulgaria, Canada, France, Switzerland, the United States and Venezuela.

[154] See section 2.5.1 of the Brazilian report.

> Hence, the Danish tax authorities are expected to follow the OECD's recommendation to use the country-by-country report solely as a risk assessment tool, not in a formula apportionment type approach. Further, on 27 January 2016 Denmark signed the Multilateral Competent Authority Agreement on the exchange of country-by-country reports."[155]

The new transfer pricing documentation standard is related to the topic of automatic exchange of tax-related information. This is another area where the optimization of tax authorities' collection instruments is ahead of concerns for the protection of taxpayers' rights. Regarding the topic, this General Reporter has stated the following in a previous work:

> "One clear aspect of the way in which the exchange of information for tax purposes is being treated is the fact that the protagonists in the discussions on the matter are the states, themselves. The taxpayers only have, at best, a supporting role to play, although it is constantly stated that the preservation of their rights is fundamental. After all, it would be impossible to imagine a perspective that advocated disregard for the rights of taxpayers, although, in most cases, practice appears to be somewhat distant from theory."[156]

One of the most relevant aspects related to the protection of taxpayers' rights in the context of the exchange of tax-related information is the confidentiality of the information actually transferred from one jurisdiction to another. Therefore, it is no surprise that the issue was raised in some reports.

According to the Austrian branch report, "the confidentiality of the data provided to other tax authorities must be ensured at the level of all the tax authorities involved. Also, the use of such information needs to be discussed."[157] Belgium's report raised the same issue, stating that, "[c]oncerning the exchange of CbCR between tax authorities, the law of 2016 does not provide any specific obligations for the tax authorities in order to guarantee the strict confidentiality of the information included in the CbCR. This creates a major concern for MNEs."[158] According to the branch report from Singapore, the country-by-country reporting information exchange will only take place "after establishing that the jurisdictions have a strong rule of law and are able to ensure confidentiality".[159]

One aspect related to the new model for transfer pricing documentation that generates a lot of concern across the board is the increase in compliance costs – even though some reporters mentioned that such costs will tend to decrease in the future as MNEs become used to the new requirements.

155 See section 2.5.1 of the Danish report.

156 Sergio André Rocha, "Exchange of Tax-Related Information and the Protection of Taxpayer Rights: General Comments and the Brazilian Perspective" (2016) 70(9) *Bulletin for International Taxation*, p. 502.

157 See section 2.5.1 of the Austrian report.

158 See section 2.5.1 of the report from Belgium.

159 See section 2.5.1 of the report from Singapore.

11.1. Compliance costs

One of the concerns of MNEs with the BEPS work on transfer pricing documentation is the increase in compliance costs, especially during a period of financial crisis and limited resources. As mentioned by the Turkish branch reporter, "[c]ompliance costs cover documentation, employing personnel, fees paid to consulting firms assigned to a joint study, and the fines incurred if compliance falls short".[160]

The Australian report raised two important concerns related to compliance costs connected with the BEPS project outcomes: (a) the potential duplication of ancillary obligations; and (b) the risk of high fines that companies will be exposed to. In the words of the reporters:

> "The further requirement of the three reports packaged as country-by-country reporting is a significant shift in the obligations on taxpayers. In addition to the extra compliance costs, penalties for non-compliance will also be significant. Entities which fail to comply with country-by-country reporting obligations will face administrative penalties, which are currently A$4,500 but proposed to increase to A$450,000 for significant global entities. Failure to comply is also likely to lead to future increased scrutiny by the ATO with indications that non-compliant taxpayers will be viewed adversely in risk assessment and audit scenarios. At the time of introduction, concern was raised by tax practitioners about the reporting requirements being potentially cost intensive for taxpayers. This concern centred around whether other jurisdictions would move towards a similar system to reduce global compliance costs. To date, there is a global move towards country-by-country reporting thereby reducing the need for more than one set of reports."[161]

A similar concern was raised in the branch report from Belgium:

> "The additional administrative costs relating to the gathering of the requested information could divert MNEs from their core business while they will not gain any benefit from it. The OECD has not recommended replacing current domestic requirements for TP documentation by the three-tier approach so that each country is free to add the OECD filing to its existing documentation requirements. Moreover, MNEs had expected that, as a compensation for all the additional constraints contained in the BEPS report, a mandatory and binding arbitration provision would be added to the multilateral instrument foreseen in Action 15 of the BEPS report, allowing the removal of double taxation within a fixed timeframe."[162]

Another concern, highlighted in the Hungarian report, is the potential impact of compliance costs on small MNEs. According to the branch reporter:

[160] See section 6.3 of the Turkish report.
[161] See section 2.5.3 of the Australian report.
[162] See section 2.5 of the report from Belgium.

> "In Hungary there are numerous MNE entities which are considered as small in terms of revenue, headcount and balance sheet total; however, they are still expected to participate in CbCR if the MNE group becomes obliged to do so. From a Hungarian perspective CbCR would create a disproportionately high compliance burden for the smallest entities. Therefore, it would be beneficial to seek for a solution that would still exempt such entities from reporting; however, the probability of this change is rather low, as BEPS Action 13 provides sufficient argumentation that once an MNE group becomes obliged to perform CbCR, in no event can any of its constituent entities become exempted from the reporting obligation."[163]

The Indian branch reporters voiced concern about the potential costs related to audits that might be triggered by country-by-country reporting:

> "in view of the risk-based audit process introduced recently, it is expected that smaller groups of companies will be taken up for audit, but these are likely to be the outcome of CbCR review, for which the department is expected to deploy analytical tools. More detailed scrutiny will, therefore, be adopted for such companies. The Indian experience has been that several cases are normally taken up for audit and even then, the intensity of audit is considerable. This is expected to be increased due to the smaller number of cases and the focus on BEPS-related issues. Therefore, it is presumed that in addition to compliance costs, there will be more spending to defend the audit and possible litigation for AEs [associated enterprises] whose parent companies meet the CbCR threshold."[164]

The concern with defence costs was also raised in the Swedish report.[165]

Reports from other jurisdictions also pointed out that the post-BEPS transfer pricing standards might increase costs for MNEs.[166] Few reports supported the view that no additional compliance costs should be expected.[167] The branch report from Singapore supported the view that, even though compliance costs tend to increase, "looking at it from the group's perspective, efforts aimed at achieving the international harmonization of TP documentation could help MNEs avoid costly duplicative work derived from the multiplicity of documentation regulations in different countries".[168]

The South African reporters pointed out that there is another side to the story. They highlighted that the tax authorities' administrative burden would also be increased. In their words, "[a]lthough the influx of detailed TP information will add to the SARS arsenal in its fight against 'transfer mispricing' (as it has come to

163 See section 2.5.3 of the Hungarian report.
164 See section 2.5.3 of the Indian report.
165 See section 2.5.4 of the Swedish report.
166 See reports from Austria, Brazil, Chinese Taipei, Colombia, Denmark, Finland, France, Germany, Japan, Korea, Malaysia, the Netherlands, Peru, Poland, Portugal, Ukraine and the United Kingdom.
167 See reports from Canada, New Zealand and Switzerland.
168 See section 2.5.3 of the report from Singapore.

be known), the increased disclosures and filings, along with the duty to exchange the information with other competent authorities, will also add significantly to the SARS' administrative burden".[169]

11.2. Can BEPS work in favour of MNEs?

To some extent, the search for transparency in the context of the BEPS project has been one sided, primarily focusing on generating information for tax administrations.[170] However, automatic exchange of information could also work in favour of taxpayers, with tax authorities automatically exchanging information necessary for the application of domestic transfer pricing regulations.

In general, branch reporters did not mention any specific initiative to use tax transparency in favour of MNEs. Moreover, some reports made explicit reference to the one-sided focus of the BEPS project.[171] However, some reports indicated potential benefits that international tax transparency could bring to MNEs.

According to the Australian report, there are two ways in which "the information gathering initiatives of the BEPS project may arguably benefit MNEs operating in Australia": (a) "information provided in the country-by-country report and master file may assist the local entity to comply with its domestic TP documentation requirements"; and (b) despite the overall confidentiality of the information provided, "there are new transparency initiatives which may assist MNEs to obtain limited information about their competitors".[172]

The Canadian report pointed out that "[t]he creation of a largely uniform cross-border system of reporting and taxation may, ultimately, increase certainty and reduce compliance costs for MNEs. Increased transparency may also improve public perception of MNEs' compliance with tax laws."[173]

The European Union reporters mentioned that:

> "Measures such as the TP documentation, when they are coordinated in the EU, have proved that they ensure uniformity in the implementation at EU level, more consistency and economies of scale for companies. A similar approach has been taken as regards the amendments to the EU directive on exchange of information which was adopted on 25 May 2016, which complements the EU TPD."[174]

France's branch report focused on the potential for information gathering in the new transfer pricing documentation rules, indicating that:

[169] See section 2.5.3 of the South African report.

[170] As pointed out by the General Reporter, "In choosing between the effectiveness of the exchange of information and protection of the rights of the taxpayers, greater importance has been attached to the former, thereby leaving the rules governing the rights of taxpayers to the domestic legislation of the states involved. Even then, these are always subject to the principle that rights guaranteed by domestic law cannot jeopardize the exchange of information." Sergio André Rocha, "Exchange of Tax-Related Information and the Protection of Taxpayer Rights: General Comments and the Brazilian Perspective" (2016) 70(9) *Bulletin for International Taxation*, p. 503.

[171] See reports from Mexico, Poland and Singapore.

[172] See section 2.7 of the Australian report.

[173] See section 2.7 of the Canadian report.

[174] See section 2.6 of the report from the European Union.

> "This move towards transparency and exchange of information would lead groups to collect, more systematically and on a larger scale, information that may have been somewhere in the accounts or in a specific subsidiary but has not been used to date. It may also lead to the setting in place of specific procedures or methodologies to find and keep information which was not collected before, or to collect much more detailed figures and indicators."[175]

The Polish report highlighted that the potential increase in transfer pricing audits could lead to an increase in double economic taxation. Therefore, one potential advantage of the BEPS project would be the enhancement of dispute resolution mechanisms.[176]

The report from the Portuguese branch also referred to the prevention of double taxation situations as one of the upsides of BEPS, adding that "[a]nother potential benefit for MNEs could be a greater consistency of application of TP rules within the OECD that could derive from the CbCR requirements and the new BEPS guidance".[177]

According to the Spanish report, "the tax authorities could obtain from foreign tax authorities information on intercompany transactions that simplify taxpayers' obligations, during the course of an audit of TP documentation".[178]

Like the Canadian report, the UK report also referred to the BEPS project's potential to "restore public trust in the system and framework for the taxation of international business". As pointed out in other reports, the UK report also mentioned that the improvement of dispute resolution would also be an upside to taxpayers.[179]

In the view of the Uruguayan reporters:

> "If countries converge towards a common interpretation of the arm's length principle and the proposed measures are adopted in a global, coherent and coordinated manner, there would be a legal framework that would provide security and avoid double taxation internationally. In this sense, the BEPS project would favour MNEs. Otherwise, dispute resolution mechanisms will operate as a safeguard."[180]

It is not unusual for MNEs to have compliance issues in their own jurisdiction because of problems in providing proof of information from other jurisdictions. This is true with respect to transfer pricing, but also in relation to other areas such as the use of foreign tax credits and application of controlled foreign company (CFC) regulations, where local compliance could be made easier – or even replaced – by information directly exchanged between tax authorities.

175 See section 3.7 of the French report.
176 See section 2.7 of the Polish report. Also see the report from Singapore.
177 See section 2.7 of the Portuguese report.
178 See section 2.7 of the Spanish report.
179 See section 2.7 of the UK report.
180 See section 3.7 of the Uruguayan report.

11.3. Summary

The summary of this section is as follows:

- Country-by-country reporting will become a reality. In most cases jurisdictions will also implement – or will already have in place – the master and local file requirements.
- In general, there is a concern that the new transfer pricing documentation package will increase MNE compliance costs – even though a few branch reporters mentioned that this cost increase would only take place in the early years of implementation.
- With respect to the potential upsides of the BEPS project Actions 8–10 outcomes, five items can be singled out:
  - the new obligations can provide more certainty and assist companies in complying with their domestic obligations;
  - companies would benefit from the overall improved and more thorough treatment of the group economic information;
  - transfer pricing harmonization will help avoid double taxation;
  - improvements are likely in dispute resolution;
  - damage to companies' image caused by tax scandals might start to be overcome by the perception that gaps that allow aggressive tax planning are being closed.

12. Transfer pricing-related measures in other BEPS actions and other measures against BEPS

It is a fact that transfer pricing is at the core of the BEPS project. Therefore, it comes as no surprise that other BEPS actions rely on changes in transfer pricing rules to achieve their goals. For instance, Action 1 and the work to address BEPS challenges in the context of the digital economy has a close interaction with transfer pricing, notably the control of transactions involving intangibles. In this section, reporters analysed whether there have been any transfer pricing developments in their jurisdiction that were driven by any BEPS actions not directly related to transfer pricing.

In jurisdictions that are members of the European Union, the implementation of transfer pricing measures that are related to non-transfer pricing actions is very much related to the European Union's anti-tax avoidance package. This aspect was highlighted in the Bulgarian report, as follows:

> "Bulgaria has not yet implemented any specific TP-related measures in other BEPS actions and other measures against BEPS. This is due largely to the fact that Bulgaria, as an EU Member State, has to implement the BEPS measures in an EU law compliant manner and it is expected that new EU law ensuring a common approach by all Member States in respect of BEPS-related measures will be enacted soon.
>
> In particular, in January 2016 the EU Commission introduced its anti-tax avoidance package, which contains, among other things, a draft anti-tax avoid-

> ance directive proposing common minimum solutions for the implementation of the BEPS measures and a proposal for a directive implementing the country-by-country reporting envisaged by the BEPS project. In its communication of 28 January 2016 for the introduction of the anti-tax avoidance package, the EU Commission has expressed its position that the Member States should develop a common approach to BEPS-related measures, which should include, *inter alia*, minimum standard measures to be implemented in every Member State. In the view of the EU Commission this should be done through the legal instruments of EU law which would ensure that BEPS-related measures were implemented in a coordinated manner in all Member States.
>
> Against this background, it is clear that Bulgaria will not undertake unilateral measures to implement BEPS solutions, but would rather wait for the development of a coordinated approach across the EU."[181]

Some branch reporters stated that nothing significant in relation to transfer pricing issues in other BEPS actions had happened in their jurisdiction.[182]

The Australian report pointed out that its most important transfer pricing development, which was domestic, would have impacts on other BEPS actions.

Many reporters mentioned that there had been movements from a domestic perspective in relation to other BEPS actions. However, such movements had no relation to transfer pricing.[183]

12.1. Summary

At this point, there is very little progress in this area, and few reporters commented on relevant developments in this area.

13. What is the future of transfer pricing?

The BEPS project work on transfer pricing is not a finishing line, but another step in the development of rules that are effective in the fair allocation of taxing rights among jurisdictions in cross-border transactions within MNE groups. Therefore, one of the major goals of this General Report was to invite IFA branch reporters to comment on what the future holds. Such comments from branch reporters are included in the list below:

- Some reports reinforced the notion that the arm's length principle – even in a revised form – will remain the dominant criterion for allocating taxing rights in cross-border transactions within MNE groups.[184]

[181] See section 2.6 of the Bulgarian report. See also section 2.6 of the Finnish report, section 3.6 of the French report, section 2.6 of the Luxembourg report and section 2.6 of the Swedish report.

[182] See reports from Argentina, Chinese Taipei, Korea, Liechtenstein, Malaysia, Portugal, Uruguay and Venezuela.

[183] See reports from Austria, Italy, India, New Zealand, Norway, Singapore, South Africa, Sweden, Switzerland, Ukraine and the United States.

[184] See reports from Australia, Finland, Italy and the United States.

- Many branch reports made explicit reference to the fact that one future trend will be the alignment with the transfer pricing BEPS outcomes, indicating that the reshaped arm's length principle will become the global standard.[185]
- The branch reporters from France, Liechtenstein and Korea pointed out that the new approach of the arm's length principle tends to increase the number of cases of double taxation.
- In line with this position, some reports suggested that the BEPS project raised awareness about the problems existing in the allocation of taxing rights in cross-border transactions within MNE groups. In this context, they foresee a future where audits will be increased as tax authorities try to collect more tax revenues.[186] The Bulgarian report highlighted that the focus on transfer pricing and the current scenario tend to increase international disputes about tax revenues.
- Reporters also mentioned that the future of transfer pricing includes a focus on the avoidance of double taxation and dispute resolution.[187]

In the European context, reports from France and Portugal pointed out that the future of transfer pricing might be connected with some degree of harmonization, in the context of the debates revolving around the CCCTB. This aspect was also included in the report from the European Union. In the words of the reporters:

> "a key initiative resulting in a broader approach is the relaunch of the CCTB/ CCCTB in a two-staged approach. Indeed, on different aspects, including fighting against transfer pricing as a profit shifting route and removing the need for complex and costly TP rules, the EU Commission concluded that the CCCTB would be the more appropriate solution for the EU and therefore re-launched the directive proposal."[188]

France and Liechtenstein noticed that the future of transfer pricing might bring about an increase in the use of profit split mechanisms, in the light of the shortcomings of the traditional arm's length approach. The reporter from Liechtenstein stated that "various forms of formulary apportionment and profit splits are on the rise". However, as highlighted in the same report, "formulary apportionment in the international context would only work if all jurisdictions worldwide agreed on the same tax base calculation and the same formula to apportion the MNE's global profits".[189]

The French report identified an interesting aspect, which is related to the "popularization" of transfer pricing debates. In the words of the branch reporter:

> "TP aspects may become a matter of concern for people outside the traditional tax area. If more information is made public, this will become of specific interest for non-tax partners of MNEs, whether employees, NGOs, customers, share-

185 See reports from Australia, Austria, Belgium, Bolivia, the Czech Republic, Germany, Japan, Korea, Mexico, Peru, Singapore, South Africa, Spain, Sweden and the United Kingdom.
186 See reports from Finland, France, Hungary, New Zealand and Sweden.
187 See reports from Austria, Italy, Korea and South Africa.
188 See section 3 of the EU report.
189 See section 3 of the report from Liechtenstein.

holders or managers of the group. This has already started, in France as in other European countries, due to recent leaks and following the recent public actions of Mrs Vestager, the European Commissioner for Competition. Specific technical attention may then be needed to design a TP policy, which would have to be simple enough to be explained to the public and to carefully ensure the full implementation of that policy, to avoid an adverse impact on the group brand and image."[190]

In addition to these topics, and considering comments presented in previous sections, it is possible to state that the future of transfer pricing also entails the following:

- A tendency to prefer economic substance over legal form. Even reporters from jurisdictions where legal formalism still prevails as a general rule – see the cases of Belgium and Canada – noted that transfer pricing was an exception to this general rule.
- Along these lines, there is a clear trend for the complete disregard of extreme business models and structures that rely only on a strict formalist transfer pricing approach.
- Even though there is no indication that an extremely simplified approach, such as the Brazilian approach, will become a global standard, there is some movement in the direction of simplification, as seen in the case of transactions with commodities and low value-adding services.

One relevant aspect that will be present in discussions about the future of transfer pricing is whether the OECD is moving in the direction of some form of formulary apportionment and whether country-by-country reporting would be a first stage of implementation. The only report to mention this aspect was the Danish report, which expressly rejected the use of country-by-country reporting as a first step in the direction of formulary apportionment. According to this jurisdiction's report, "the Danish tax authorities are expected to follow the OECD's recommendation to use the country-by-country report solely as a risk assessment tool, not in a formula apportionment type approach".[191]

Another topic that must be debated is whether the new approach to transfer pricing might be used to shift tax revenues to developed jurisdictions in the context of global MNEs, under the argument that entities located there undertake more functions and risks. This concern is particularly relevant in a world of intangibles and a system that pays little attention to the consumer market as a driver for value creation. As pointed out by the Brazilian branch reporters, "[t]he main impact of this concept is the transfer of taxing rights to states where highly skilled personnel and valuable technologies are located. The concept ignores the importance of the market for the creation of value, being a biased interpretation of the ALP, which cannot be inferred from its wording."[192]

[190] See section 4 of the French report.
[191] See section 2.5.1 of the Danish report.
[192] See section 3 of the Brazilian report.

Furthermore, there is also a concern – which permeates the entire BEPS project – that the tax sovereignty of jurisdictions could be affected.[193] This topic was mentioned in the Liechtenstein report:

> "another major concern is that certain individual countries or supranational institutions are now taking advantage of the changing environment to implement unilateral measures which go far beyond the consensus reached under the BEPS project and which will lead to even higher compliance costs and, at least to some extent, also prohibit the implementation and/or maintenance of consistent and coherent tax and TP policies. This will, in turn, again affect the ability to defend the appropriateness of a given transaction as there may no longer be an agreed fundamental principle which can be used on all sides of the transaction."[194]

[193] This General Reporter, together with one of the General Reporters of subject 1, Professor Allison Christians, edited a book on the topic of sovereignty in post-BEPS times that will be released later this year. Sergio André Rocha and Allison Christians (eds.), *Tax Sovereignty in the BEPS Era* (The Netherlands: Kluwer, 2017).

[194] See section 2.5 of the report from Liechtenstein.