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AN ALERT FROM THE BDO INTERNATIONAL TAX PRACTICE

BDO KNOWS: BASE EROSION AND PROFIT SHIFTING (BEPS)

SUBJECT

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD) ISSUES FINAL REPORT ON ACTION ITEMS 8-10: ALIGNING TRANSFER PRICING OUTCOMES WITH VALUE CREATION

SUMMARY

This alert is one installment in a series of alerts on the release of the OECD/G20 Base Erosion and Profit Shifting Project (the BEPS Project).

On October 5, 2015, the OECD released the final report (the "Report") of the BEPS Project. This alert discusses the final report with respect to Action Items 8-10: Aligning Transfer Pricing Outcomes with Value Creation.

The OECD, a non-governmental forum established to promote economic growth, has developed a 15-point action plan to shape "fair, effective and efficient tax systems." The OECD's project regarding BEPS has addressed issues arising from tax planning strategies that exploit gaps or mismatches in member countries' tax rules.

BACKGROUND AND DETAILS

In an effort to address BEPS issues in a coordinated and comprehensive manner, the G20 finance ministers called on the OECD to develop an action plan to equip countries with instruments that will better align tax with economic activity. Action Items 8-10 of the BEPS Project specifically addresses the alignment of transfer pricing outcomes with value creation.

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Action Items 8- 10 were released in a single report that addresses transactions involving intangibles, risk, and capital transfers between group entities, and other high-risk transactions.

The Report makes the following recommendations to employ BEPS-prevention strategies:

- Action Item 8 concerns the movement of intangibles among related entities. The proposed measures recommend the adoption of a broad and clearly delineated definition of intangibles, which will ensure that profits associated with the transfer and uses of intangible property are appropriately allocated in accordance with value creation. Additional recommendations include the development of transfer pricing rules or special measures for transfers of hard to value intangibles, and updating the guidance on cost contribution (cost sharing) arrangements.
- The transfer of risks and allocation of capital amongst related entities are covered under Action Item 9. This action item outlines transfer pricing rules or special measures to ensure that an entity does not accrue inappropriate returns solely based on contractually assumed risk or the provision of capital.
- Transactions that would not, or would rarely, occur between third parties are addressed under Action Item 10. The Report recommends the adoption of transfer pricing rules or special measures. These measures are intended to clarify the re-characterization of transactions and the application of transfer pricing methods with respect to global value chains, as well as provide protection against common types of base eroding payments.
- As the issues covered by Action Items 8- 10 are closely related, it may be necessary to finalize them concurrently. Therefore, certain sections within the action items are to be considered interim guidance drafts. These sections cover special measures such as authorizing tax administrations to apply rules based on actual results when pricing hard-to-value intangible transactions; reducing the return to entities whose activities are limited to funding the development of intangibles; requiring contingent payment terms, and/or the application of profit split methods for transfers of hard-to-value intangibles; and applying rules that are analogous to Article 7 and the Authorized OECD Approach to excessive capitalization of low function entities. The countries involved in the BEPS project intend to finalize these sections, among others, later this year.

BDO INSIGHTS

Actions 8-10 will require multinational enterprises to place more emphasis on the actual conduct of the respective parties involved when determining the pricing of an intercompany transaction. The alignment of transfer pricing outcomes with value creation is expected to result in a greater reliance on transfer pricing documentation to describe the relationship between value drivers and the functions, assets, and risks undertaken by the parties to an intercompany transaction. The implementation of these action items may result in disagreements among various jurisdictions.