
Aligning transfer pricing outcomes with value creation – revised Chapters I, II, VI, and VII of the OECD Transfer Pricing Guidelines

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In brief

On 5 October 2015, the OECD presented its final package of measures for a comprehensive, coherent, and co-ordinated reform of the international tax rules. The package was endorsed by the G20 Finance Ministers at their meeting on 8 October 2015, in Lima, Peru. This final package (referred to below as the “Final Report”) includes the work undertaken by the OECD in relation to Aligning Transfer Pricing Outcomes with Value Creation, Actions 8 to 10 of its Base Erosion and Profit Shifting (BEPS) Action Plan, which focuses on ensuring that transfer pricing outcomes are aligned with value creation.

The OECD work in the context of Actions 8 to 10 of the Final Report includes guidance on several key transfer pricing areas. These include: (1) the accurate delineation of intercompany transactions; (2) future work to be completed on the transactional profit split method; (3) transactions involving intangibles; (4) commodity transactions; (5) “low-value adding intra-group services” transactions; and (6) cost contribution arrangements (CCAs).

Some key takeaways from the almost 200 pages of guidance are:

The accurate delineation of intercompany transactions is paramount, and the conduct of parties will prevail over contractual arrangements where there is a misalignment between the two;

- A six-step process for identifying risk is provided, with the return for risk allocated to the party that controls the risk and has the financial capacity to assume it;
- Returns from intangibles accrue to the entities that carry out the development, enhancement, maintenance, protection, and exploitation functions, and not necessarily to the legal owner of the intangibles;
- Clearer guidance on the application of comparable uncontrolled prices (CUPs) to commodity transactions is offered;
- A safe harbour of five percent is established for low-value adding intra-group services; and

- CCA participants must have the capability and authority to control risks associated with the risk-bearing opportunity. Current contributions can be valued at cost, but pre-existing contributions should be valued under guidance of Chapters I, II, and V of the OECD Transfer Pricing Guidelines.

The guidance published by the OECD attempts to ensure that transfer pricing outcomes align with value creation of multinational enterprise (MNE) groups, while the holistic link with other items of the BEPS Action Plan should make the role of capital-rich, low functioning entities in a post-BEPS world less relevant. In doing so, the OECD has avoided the need to develop special measures outside of the arm's-length principle.

Overall, this new guidance likely will result in increased scrutiny from tax authorities, which in turn will place a higher compliance burden on all multinational enterprises. This article provides a comprehensive synopsis of the issues covered by Actions 8 to 10, including analysis of revisions made since the Public Discussion Draft on Actions 8 to 10 was released on 1 December 2014 (Discussion Draft). For an overview of the other BEPS Action Plan items, see [PwC's Tax Policy Bulletin dated 5 October 2015](#).

In detail

Guidance for applying the arm's-length principle

While the Discussion Draft placed a stronger emphasis on the re-characterisation of transactions, the Final Report focuses on the importance, through a transfer pricing comparability analysis, of accurately delineating transactions between associated enterprises by examining contractual relations against the actual conduct of the parties. Accordingly, under the principles in the Final Report, transactions will generally continue to be respected, consistent with the previous version of the OECD Transfer Pricing Guidelines, if they possess commercial rationality evidenced by the substance of the conduct of the parties. Such conduct is identified through the "commercial or financial relations" between the associated enterprises in light of the economically relevant conditions (see paragraph 1.33 of the Final Report).

A key theme throughout the Final Report is that while contractual allocations of risk may provide a starting point, such allocations are subject to a substantive analysis of the economic behaviour of the parties in the context of the entire value chain of MNEs. Furthermore, the

appropriateness of these allocations is to be considered in relation to the measures that unrelated parties engaged in a comparable relationship would assume. Finally, legal ownership or financial risk-taking alone does not create an entitlement to profits.

In effect, the OECD is proposing to look at contractual terms and actual legal ownership in light of the substance of the "commercial or financial relations" between related parties in order to form a basis to compare how unrelated parties would behave under similar circumstances. The Final Report also affirms the exceptionality of re-characterisation and the importance of accurately delineating transactions through a detailed functional analysis.

To further meet the objective of accurately delineating transactions consistent with value creation principles, the Final Report explicitly authorizes the recasting of contractual terms to reflect the commercial or financial relations that actually exist between the parties based on their conduct and the economically relevant characteristics of the transaction, including options realistically available to the parties (see paragraphs 1.38 and 1.43). If such conduct and characteristics "that are economically relevant are inconsistent

with the written contract between the associated enterprises, the actual transaction should generally be delineated for purposes of the transfer pricing analysis in accordance with the characteristics of the transaction reflected in the conduct of the parties" (see paragraph 1.45, Section D.1.1). In essence, the Final Report questions the inherent trustworthiness of the terms of contracts entered into between related parties as a stand-alone basis for risk allocation and, instead, identifies the conduct of the associated enterprises as the ultimate deciding factor in accurately delineating a transaction and aligning transfer pricing outcomes.

The Final Report diverges from the Discussion Draft with respect to the concept of "moral hazard." This concept was introduced in the Discussion Draft and defined as a situation in which one party assumes risk without having control over any consequences related to that risk. This concept received significant criticism from interested parties and ultimately was abandoned.

Functional analysis and risk assessment

The Final Report modifies provisions that describe the information that should be considered in a functional analysis. Most significantly,

paragraph 1.56 of section D.1.2.1. states that "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." This section sets out a six-step analytical framework for identifying risks with specificity; determining their contractual allocation; identifying the enterprises that control and manage risk, absorb the favourable or unfavourable consequences of risk, and have the financial capacity to assume the risk; evaluating whether the information gathered in Steps 1-3 is consistent with the contractual terms of the transaction; re-characterising risk if appropriate under the guidance provided; and finally, if required, pricing the controlled transaction based on risk assumption and risk management functions.

Two key concepts related to risk allocation that are emphasized throughout the Final Report relate to control over risk and financial capacity to assume risk. Consistent with the Discussion Draft, the Final Report makes it clear that "to assume a risk for transfer pricing purposes, the associated enterprise needs to control the risk and have the financial capacity to assume the risk." See Actions 8 to 10 Executive Summary of the Final Report. Paragraph 1.65 of section D.1.2.1. defines control over risk as "(i) the capability to make decisions to take on, lay off, or decline a risk-bearing opportunity, together with the actual performance of that decision-making function and (ii) the capability to make decisions on whether and how to respond to the risks associated with the opportunity, together with the actual performance of that decision-making function."

In essence, the guidance looks at the enterprise's capability to perform risk management decision-making functions as well as the actual performance of such functions. Additionally, the Final Report clarifies that in order to have control over risk, an enterprise is not required to perform the risk mitigation activities itself, but it is required to be actively involved in the decision process when outsourcing these activities. Financial capacity refers to an enterprise's capability to access funding when managing risk as well as absorbing the consequences of risk in the event of an unfavourable outcome (see paragraph 1.64 of section D.1.2.1). The Final Report does not, however, provide guidance on how to determine as a practical matter an appropriate allocation of risk based on the above risk analysis, which taxpayers and tax authorities will have to determine in practice.

Another key aspect of the Final Report is the guidance provided in regard to the relationship between the functions performed and corresponding allocation of returns. Specifically, the guidance provides that capital-rich entities that do not perform any relevant economic activities and do not exercise control over the financial risk will not be allocated any excess profits and will not be entitled to any more than a risk-free return (see paragraph 1.103 in section D.1.2.1.6). As mentioned in the Actions 8 to 10 Executive Summary of the Final Report, such guidance is linked with other Actions, such as ensuring that capital-rich entities without any other relevant economic activities (i.e., "cash boxes") will not be entitled to any profits beyond those that appropriately remunerate their contributions.

Non-recognition of transactions

Section D.2. of the Final Report discusses the exceptional

circumstances under which transactions can be disregarded or re-characterised for transfer pricing purposes. In particular, paragraph 1.122 states that "[w]here the same transaction can be seen between independent parties in comparable circumstances... non-recognition would not apply. Importantly, the mere fact that the transaction may not be seen between independent parties does not mean that it should not be recognised." The Final Report recognises the fact that associated enterprises may have the ability to enter into a much wider variety of arrangements than their unrelated counterparts, and therefore calls for an analysis of whether the arrangement possesses commercial rationality that would be seen should such a transaction take place between unrelated parties.

Retreat from "fundamental economic attributes" principle and need for special measures

The Final Report departs from the notion of "fundamental economic attributes" that was introduced in the Discussion Draft as a replacement for the "commercial rationality" principle used in the former OECD Transfer Pricing Guidelines. The Final Report, therefore, reaffirms the principle that simply because a transaction is not seen per se between third parties, it does not follow that there is a lack of commercial rationality.

Similarly, the Discussion Draft introduced the concept of "special measures" to address transfer pricing issues associated with intangibles, risk, and over-capitalization. However, this concept was not included in the Final Report, as the Actions 8 to 10 Executive Summary states, "the goals set by the BEPS Action Plan in relation to the development of transfer pricing rules have been achieved without the need

to develop special measures outside the arm's length principle."

Guidance on the Transactional Profit Split Method

The Scope of Work for Guidance on the Transactional Profit Split Method in the Final Report is limited to five pages, mainly describing comments received and considered by Working Party No. 6 (WP6). The Final Report acts as a basis for the draft guidance to be developed by WP6 in 2016, which is expected to be finalised in the first half of 2017.

The key themes emerging from the delegates of WP6 included the need to further consider clarifying, improving, and strengthening the guidance on when it is appropriate to apply a transactional profit split method and how to do so. WP6 acknowledged the difficulties in applying a transactional profit split method as well as the difficulties in reviewing a transactional profit split from a tax authority perspective. Nevertheless, the consultation process confirmed the usefulness of the transactional profit split method to align profits with value creation when applied appropriately.

Importantly, the Executive Summary of Actions 8 to 10 recognizes the need for improved guidance on determining when the transactional profit split is the most appropriate method for a particular set of facts and approaches to split profits in a reliable manner. The Executive Summary also notes that future guidance should take into account the conclusions from the work related to BEPS Action 1 – Addressing the Tax Challenges of the Digital Economy. Similarly, the Executive Summary states that future guidance should consider the work undertaken in situations where reliable comparable transactions are limited.

Scope of revised guidance

The Final Report identifies issues with which WP6 struggled and notes that revised guidance should clarify and supplement a number of issues addressed in comments to the Discussion Draft. The comments include:

- Concerns that the transactional profit split method may be deemed appropriate regardless of a most appropriate method analysis;
- Integration in itself may be insufficient to warrant the use of a transactional profit split method;
- Further guidance on what constitutes “unique and valuable contributions” that may make transactional profit splits the most appropriate method;
- The role of synergistic benefits and when and how such synergies should warrant use of the transactional profit split method;
- Further guidance on the mechanism used to split profits based on a functional analysis of the parties’ contributions; and
- The use of profit splits to derive a transactional net margin method (TNMM) range or in determining an expected share of profits and converting such share to a royalty amount.

Scope of revisions of the guidance on the transactional profit split method

Most appropriate method

The Final Report recognises that identification of the nature of a transaction is critical to a proper most appropriate method analysis. For instance, the Final Report notes that the sharing of profits/losses under a profit split may fundamentally alter

the commercial relationship between the parties as compared to a one-sided method of paying a fee for goods/services. In such a scenario, the Final Report correctly recognises that using inexact comparables likely will be more reliable than inappropriately using the transactional profit split method. Thus, future guidance will include an expanded discussion on how the most appropriate method should be applied in such cases.

Highly integrated business operations

The Final Report states that additional guidance will be provided as to when significant integration of a business may lead to the conclusion that a transactional profit split is the most appropriate method. Further guidance may include examples distinguishing between sequential integration (i.e., parties performing different activities in a value chain) as compared to parallel integration (i.e., parties performing similar activities in the same revenue stream).

Synergistic benefits, profit splitting factors and use of profit split to determine TNMM range, royalty rates and other payment forms

The Final Report also notes that additional guidance will be provided discussing significant group synergies, mechanisms used to split profit, and the use of a profit split even when not selected as the most appropriate method, although limited detail is provided.

Intangibles

The OECD has made great progress to provide guidance specifically tailored to determining arm's-length conditions for transactions that involve the use or transfer of intangibles and the parts dealing with “ownership of intangibles and transactions involving the development, enhancement, maintenance, protection and

exploitation of intangibles” in particular.

The final OECD guidance confirms a major takeaway of the previous Discussion Draft that although determining legal ownership and contractual arrangements is an important first step of the transfer pricing analysis, the determination thereof is separate and distinct from the question of remuneration under the arm’s-length principle. The OECD confirms in its final guidance that, for transfer pricing purposes, legal ownership of intangibles, by itself, does not confer any right ultimately to retain returns derived by the MNE group from exploiting the intangible even though such returns initially may be accrued to the legal owner as a result of its legal or contractual right to exploit the intangible.

The return ultimately retained by or attributed to the legal owner depends upon the functions it performs, the assets it uses, and the risks it assumes and upon the contributions made by other MNE group members through their functions performed, assets used, and risks assumed. As a result, legal ownership and contractual relationships merely serve as reference points for identifying and analysing controlled transactions relating to the intangible and for determining appropriate remuneration to members of a controlled group with respect to those transactions.

In this respect, the OECD has introduced – for transactions involving intangibles – an analytical framework comparable to that introduced in Chapter I of the OECD Guidelines for analysing risks, consisting of the following six steps:

1. Identify the intangibles used or transferred in the transaction with specificity;

2. Identify the full contractual arrangements with special emphasis on determining the legal ownership of intangibles;
3. Identify parties performing functions, using assets, and assuming risks related to development, enhancement, maintenance, protection, and exploitation of the intangibles through a functional analysis;
4. Confirm the consistency between the terms of the contractual arrangements and the actual conduct of the parties;
5. Delineate actual controlled transactions in light of the legal ownership, other relevant contractual relations, and the actual conduct of the parties; and
6. Where possible, determine arm’s-length prices consistent with each party’s contribution of functions performed, assets used, and risks assumed.

The above analytical framework thus implies that one needs to ensure that all members of the MNE group are appropriately compensated for the functions they perform, the assets they contribute, and the risks they assume. This implies that the legal owner of intangible will only be entitled to retain all the returns derived from the exploitation of the intangible in case (i) it performs all the functions; (ii) contributes all assets used; and (iii) assumes all risks related to the development, enhancement, maintenance, protection, and exploitation of the intangible.

The focus by the OECD on functional value creation does not imply that it is essential for the legal owner to physically perform all the functions related to the development, enhancement, maintenance, protection, and exploitation of the

intangible through its own personnel in order to be entitled to ultimately retain all or be attributed a portion of the return derived by the MNE group from the exploitation of the intangibles.

Accordingly, the legal owner could outsource functions to independent or dependent enterprises provided those operate under the control of the legal owner. In assessing the notion of “control,” principles analogous to those for determining control over risk apply. To the extent the legal owner neither controls nor performs the functions related to the development, enhancement, maintenance, protection, and exploitation of the intangible, the legal owner would not be entitled to any ongoing benefit attributable to the outsourced functions. Depending on the facts and circumstances, the compensation to be provided to other MNE group members actually performing or controlling those functions might constitute all or a substantial part of the return anticipated to be derived from the exploitation of the intangible.

As regards the assessment of the appropriate return to funding of development, enhancement, maintenance, protection, and exploitation of intangibles, the OECD guidance states that a party that provides funding without controlling the risk or performs other activities associated with the funded activity or asset generally does not receive anticipated returns equivalent to those received by an otherwise similarly situated investor who also performs and controls important functions and bears and controls important risks associated with the funding activity.

When identifying risk in relation to an investment with specificity, it is important to distinguish between the financial risks related to the funding

provided for the investments and the risks linked to the operational activities for which the funding is used. A party providing funding thereby exercising control over the financial risk related to the provision of funding but without the assumption of, including control over, any other specific risk, should generally only expect a risk-adjusted return on its funding but not more.

As regards the comparability analysis process for transactions involving intangibles, the transfer pricing analysis must consider the options realistically available to each of the parties to the transaction. Hence, the perspectives of each party must be considered. Accordingly, the OECD's guidance states that a comparability analysis focusing only on one side of a transaction generally will not provide a sufficient basis for evaluating a transaction involving intangibles, including in those situations for which a one-sided method is ultimately determined.

As regards the transfer of intangibles or rights in intangibles, the OECD's final guidance confirms that it is important not to simply assume that all residual profit (after a limited return to those providing functions) should necessarily be allocated to the owner of intangibles.

Rather, the selection of the most appropriate transfer pricing method should be based on a functional analysis that provides a clear understanding of the MNE's global business processes and how the intangibles interact with other functions, assets, and risks that comprise the global business. In other words, it is especially important to ground the comparability and functional analysis on an understanding of the MNE's global business by identifying all factors that contribute to value creation (which may include risks borne, specific

market characteristics, location, business strategies, and MNE group synergies). The transfer pricing method selected should take into account all the relevant factors materially contributing to the creation of value, not only intangibles and routine functions.

Although the revised guidance makes clear that any of the five OECD transfer pricing methods (as well as "alternative methods") might constitute an appropriate transfer pricing method for transactions involving transfers of one or more intangibles, the foregoing implies that the transfer pricing methods most likely to prove useful in matters involving intangibles are the CUP and the transactional profit split method. In this respect, the OECD explicitly states that a rule of thumb cannot be used to evidence that a price or apportionment of income is arm's length (including an apportionment of income between a licensor and a licensee of intangibles), whereas it does recognize that under limited circumstances, transfer pricing methods based on costs may be utilised, particularly where the intangibles are not unique and valuable (e.g., for development of intangibles used for internal business operations, such as internal software systems).

As regards valuation techniques, the OECD's guidance states that it is not the intention to set out a comprehensive summary of the valuations techniques utilised by valuation professionals nor to endorse or reject one or more sets of valuation standards. Rather, valuation techniques can be seen as useful tools in a transfer pricing analysis where reliable comparable uncontrolled transactions are not available.

The most notable other guidance relates to the amendments to Chapters I-II that now officially

address location savings and other local market features, assembled workforce, and MNE group synergies. The guidance also contains final amendments to Chapter VI with respect to arm's-length pricing of transactions involving intangibles for which valuation is highly uncertain at the time of the transaction, final guidance on hard-to-value intangibles as well as the definitional aspects of intangibles, guidance on specific fact patterns related to intangible assets often observed in practice, and a formal annex to Chapter VI that contains examples to illustrate the guidance on special considerations for intangibles.

The changes to Chapters I, II, and VI are further summarised and discussed below.

Definition of "intangible"

The final guidance as regards the categorisation of intangibles continues to broadly split intangibles into "marketing intangibles" and "trade intangibles." Also, the definition of "unique and valuable intangibles" has been incorporated into Chapter VI.

"Intangible" for the purpose of Chapter VI is intended to address "something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities and whose use or transfer, would be compensated had it occurred in a transaction between independent parties in comparable circumstances."

In addition, Chapter VI now explicitly states that it is important to distinguish intangibles from market conditions or local market circumstances that are not capable of being owned or controlled.

Amendments to Chapters I-II

Chapter I provides guidance on the application of the arm's-length principle in the context of how to

address location savings and other local market features, assembled workforce, and MNE Group synergies.

Location savings and other local market features

The revised guidance provides a framework to determine how location savings and other local market features (e.g., purchasing power and product preferences of households in the market, whether a market is expanding or contracting, the degree of competition in the market) are to be shared between two or more associated enterprises.

As regards location savings, it is necessary to consider (i) whether location savings exist, (ii) the amount thereof, (iii) the extent to which those savings are either retained by a member or members of the MNE group or passed on to independent customers or suppliers, and (iv) in case they are not (fully) passed on to independent customers or suppliers, the manner in which independent enterprises operating under similar circumstances would allocate any retained net location savings. In case the functional analysis shows that location savings exist that are not passed on to customers or suppliers and where comparable entities and transactions in the local market can be identified, those local market comparables will provide the most reliable indication regarding how net location savings should be allocated amongst two or more associated enterprises. Thus, where reliable local market comparables are available and can be used to determine arm's-length prices, specific comparability adjustments should not be required.

As regards other local market features, the most reliable approach will be to refer to data regarding comparable uncontrolled transactions in the geographic market between independent enterprises performing similar functions, assuming similar

risks and using similar assets. Where comparable transactions in the local market can be identified, specific adjustments for the features of the local market should not be required. In case those cannot be identified, a process similar to that as described above for the allocation of net locations savings will need to be performed.

Assembled workforce

According to the Final Report, the existence of a uniquely qualified or experienced cadre of employees may affect the arm's-length price of transactions between related enterprises and thus needs to be taken into account in a transfer pricing comparability analysis (to the extent it is possible to determine the benefits or detriments of a uniquely assembled workforce vis-à-vis the workforce of independent parties).

The transfer of an assembled workforce along with other assets of the business within an MNE group should not be separately compensated as a general matter. Rather, one should assess whether the transfer of the assembled workforce results in time and cost savings that need to be reflected in the arm's-length price.

One exception relates to the situation where the transfer or secondment of employees coincides with the transfer of valuable know-how or other intangibles. In such a case, this should be separately analysed under the provisions of Chapter VI and an appropriate price should be paid for the right to use the intangibles so transferred.

MNE group synergies

The Final Report addresses how MNE groups and the associated enterprises that comprise the group may benefit from interactions or synergies among group members that generally would not be available to independent enterprises. The Final Report

confirms that corporate 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.

Other key amendments to Chapter VI

Chapter VI includes Final Report on the application of the arm's-length principle in commonly occurring fact patterns with respect to intangibles. This analysis includes consideration on development and enhancement of marketing intangibles; research, development, and process improvement arrangements; and payments for the use of the company name, as follows:

- **Distribution arrangements:** The analysis should assess whether the marketer/distributor should be compensated only for providing promotion and distribution services, or whether it also should also be compensated for enhancing the value of the trademarks and other marketing intangibles by virtue of its functions performed, risks assumed, and assets used.

Where the functions performed, risks assumed, and assets used exceed those an independent distributor with similar rights might incur or perform for the benefit of its own distribution activities and that create value beyond that created by similarly situated marketers/distributors, additional remuneration in the form of higher distribution profits, a reduced royalty rate, or a share in the profits associated with the enhanced value of the trademark or other marketing intangibles needs to be considered.

- R&D arrangements: In case the R&D service provider possesses unique skills and experience relevant to the research, assumes risks (e.g., in the case of “blue-sky” research), uses its own intangibles, or is controlled or managed by another party other than the legal owner of the intangibles, cost plus a modest mark-up will not reflect the anticipated value of, or the arm’s-length price for, the contribution of the research team in all cases.

These principles similarly apply in situations where a member of a MNE group provides manufacturing services that may lead to process or product improvements on behalf of an associated enterprise that will assume legal ownership of such process or product improvements.

- Use of company name: As a general rule, no payment should be made for simple recognition of group membership or the use of the group name merely to reflect the fact of group membership. In case the use of the group name or trademark provides a financial benefit to the recipient, such a payment could be arm’s length.

In addition, Chapter VI also provides generic illustrations of items often considered in transfer pricing analyses involving intangibles such as patents, know-how and trade secrets, trademarks, licenses and similar arrangements, goodwill, etc.

With regard to the latter, it should be noted that according to the new guidance, a brand is not the same as a trademark, as a brand can represent a combination of intangibles and/or other items including trademarks, reputational characteristics, and goodwill.

Moreover, the new guidance states that reputational value transferred to or shared with an associated enterprise in connection with a transfer or license of a trademark or other intangible should be taken into account for determining appropriate compensation. If features of a business such as reputation for producing high-quality products or providing high-quality services allow that business to charge higher prices than an entity lacking such reputation, such features might need to be taken into consideration to determine an appropriate compensation.

Arm’s-length pricing of transactions involving intangibles for which valuation is highly uncertain at the time of the transaction and Hard-to-Value Intangibles

Chapter VI also includes guidance on the arm’s-length pricing of intangibles when valuation is highly uncertain at the time of the transaction and hard-to-value intangibles.

As regards the first category, the question to be answered is how arm’s-length pricing should be determined. In this respect, reference is made to what independent parties would have done in comparable circumstances to take into account the valuation uncertainty in the pricing of the transaction.

The OECD puts forth a number of mechanisms that independent enterprises might adopt to address the high uncertainty at the time of the transaction. Possibilities put forth include the use of anticipated benefits, thereby considering the extent to which subsequent developments are foreseeable and predictable. In case of unforeseeable or unpredictable events, parties could opt to adopt short-term agreements, including price adjustment clauses in the terms of the agreement, or to adopt payment structures involving contingent payments.

Finally, chapter VI states that although independent parties may determine to assume the risk of unpredictable subsequent developments, the occurrence of events (be they foreseen or unforeseen but that might change the fundamental assumptions upon which pricing was determined) may lead to a renegotiation of the pricing arrangements by the parties where it is to their mutual benefit.

In case independent parties would have agreed to include a mechanism to address high uncertainty in valuing the intangible, the tax administration should be permitted to determine the pricing of a transaction involving an intangible or rights in an intangible on the basis of such mechanism.

As regards the category of “hard-to-value intangibles,” the OECD confirms that an approach is required – consistent with the arm’s-length principle – that tax administrations can adopt to ensure they can determine in which situations the pricing arrangements as set by the taxpayers are at arm’s length (and are based on an appropriate weighing of the foreseeable developments or events that are relevant for the valuation of the intangibles involved) and in which situations this is not the case.

Chapter VI defines hard-to-value intangibles as those for which – at the time of their transfer in a transaction between associated enterprises – (i) no reliable comparable exists and (ii) at the time the transaction was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible or the assumptions used in valuing the intangible are highly uncertain.

Examples of transactions of intangibles falling within the scope of the “hard-to-value intangibles” include:

- Intangibles that are only partially developed at the time of the transfer;
- Intangibles that are not anticipated to be exploited commercially until several years following the transaction;
- Intangibles that do not fall themselves in the hard-to-value definition but that are integral to the development or enhancement of other intangibles falling within the definitional scope;
- Intangibles that are expected to be exploited in a manner that is novel at the time of the transfer;
- Intangibles meeting the hard-to-value definition transferred to an associated enterprise for a lump-sum payment; and
- Intangibles used in connection with or developed under a cost contribution arrangement (CCA) or similar arrangements.

According to the OECD, all the foregoing intangibles are examples for which information asymmetry between the taxpayer and the tax authority may be acute and may exacerbate the difficulty encountered by tax administrations in verifying the arm's-length basis on which pricing was determined. As such, the asymmetry makes it difficult for a tax administration:

- to perform a risk assessment for transfer pricing purposes;
- to evaluate the reliability of the information on which pricing has been based; or
- to consider whether the intangible or rights in intangibles have been transferred at undervalue or overvalue compared to the arm's-length price

until ex post outcomes are known in years subsequent to the transfer.

The solution put forth by the OECD to deal with those situations is to allow tax authorities to consider ex post outcomes as presumptive evidence about the appropriateness of the ex ante pricing arrangements. Nevertheless, this approach may reflect an attempt by the OECD to arrive at a solution without examining whether the perceived information asymmetry will be addressed by other measures requiring MNEs to be more transparent with information on a real-time basis than they have for decades past of tax administration.

The consideration of ex post evidence should be based on a determination that such evidence is necessary to be taken into account to assess the reliability of the information on which ex ante pricing has been based. Where the tax administration is able to confirm the reliability of the information on which ex ante pricing has been based, then adjustments based on ex post information should not be made.

In evaluating ex ante pricing arrangements, the tax administration is entitled to use the ex post evidence about financial outcomes to inform the determination of the arm's length pricing arrangements, including any contingent pricing arrangements that would have been made between independent parties at the time of the transaction.

The above approach will not apply to intangibles falling within the definitional scope when at least one of the following exemptions applies:

- The taxpayer provides:
 - Details of the ex ante projections used at the time of the transfer to determine the pricing arrangements, including how risks were

accounted for in calculations to determine the price and the appropriateness of its consideration of reasonably foreseeable events and other risks and the probability of occurrence; and

- Reliable evidence that any significant difference between the financial projects and actual outcomes is due to (1) unforeseeable developments or events occurring after the determination of the price that could not have been anticipated at the time of the transaction or (2) the playing out of probability of occurrence of foreseeable outcomes and that those were not significantly over-estimated or under-estimated at the time of the transaction;
- The transfer is covered by a bilateral or multilateral advance pricing arrangement;
- Any significant difference between the financial projections and actual outcomes do not have the effect of reducing or increasing compensation of the hard-to-value intangible by more than 20% of the compensation determined at the time of the transaction;
- A commercialisation period of five years has passed following the year in which the hard-to-value intangible first generated unrelated party revenues for the transferee and in which commercialisation period any significant difference between the financial projections and actual outcomes was not greater than 20% of the projections of that period.

The OECD explicitly states in Chapter VI that the approach put forth needs to be distinguished from the situation in which hindsight is used by taking ex post results for tax assessment purposes without considering whether the information on which ex post results are based could or should reasonably have been known and considered by the associated enterprises at the time the transaction was entered into.

The OECD indicates that it would be important to permit resolution of cases of double taxation arising from application of the approach for hard-to-value intangibles through access to the mutual agreement procedure under the applicable Treaty.

Annex to Chapter VI – Examples to illustrate guidance on intangibles

The Final Report includes numerous examples to illustrate the application of the principles outlined in the revised Chapters I, II, and VI.

Commodity transactions

The OECD's guidance on commodity transactions takes the form of additions to the section on the Comparable Uncontrolled Price (CUP) method in Chapter II of OECD Guidelines, but without the accompanying (and detailed) commentary provided in the Discussion Draft. The principles of the guidance and the underlying messages remained largely unchanged and focus on:

- the preference for applying the CUP method to the commodities-related transactions, and
- the importance of the choice of the pricing date for the application of the CUP method.

The scope of the new guidance attempts to reconcile the developments in the taxation of commodity transactions with existing

transfer pricing guidance. The Discussion Draft focused on the so-called “Sixth Methods” – different ways of setting prices for the purposes of commodity-specific taxation in several countries. This explanatory detail is absent from the changes that will be made to Chapter II, but the effect is the same: such an approach will meet the arm's-length standard provided that it is in fact an application of the CUP method as detailed in the Guidelines.

Application of the CUP method

The new guidance recognises that the use of quoted prices for commodity transactions between associated enterprises can correspond to the application of the CUP method.

The OECD, however, also recognises that this is subject to the existing guidance for selecting the most appropriate pricing method. The new text is explaining an instance of an existing TP method, not defining a new one.

The new guidance recognises the usefulness (and allows for the use) of publicly reported price data as well as quoted prices, provided that these are widely used as reference prices in transactions between unrelated parties. This means that taxpayers will be able to use reasonably common industry practice to set transfer prices and, as far as the Guidelines are concerned, ought not to be forced to apply artificial formulae they do not or only rarely encounter in practice.

By extension, however, the revised text puts the onus on the taxpayer to document and provide evidence of the industry pricing practices reflected in its transfer pricing and of the detail required to get from there to an actual transfer price.

The position of the revised text within the broader section on CUPs means that the wider guidance also should

apply, including recognition that there will rarely, if ever, be an exact and perfect price. The revised text recognises that the outcome may well be a range, but avoids specifying whether it is a price or a range that results.

Terms

These points on industry practice and range are important as the Final Report reminds tax authorities and taxpayers alike that the application of the CUP method requires “reasonably accurate” adjustments to reflect a number of factors affecting the commodities pricing, including physical features and quality of the commodities, the contractual terms, volumes traded, timing, and terms of the delivery. Helpfully, the list of potential adjustments is now explicitly open-ended, but again the onus will be on the taxpayer to correctly identify which adjustments are required and then quantify their impact.

The revised text specifically includes recognition that adjustments to the price will need to reflect the functions, assets, and risks of parties relevant to the supply chain, which should also be evaluated in accordance with the wider Guidelines. That will, of course, include the other revisions being made as part of the BEPS project including those on risk and re-characterisation. It therefore will be doubly important to ensure that the functions and risks reflected in intercompany contracts for commodities are an accurate representation of how the supply chain operates.

Achieving all this will increase the documentation burdens taxpayers face, especially as the new Guidance specifies that the taxpayer should provide the information needed to justify the pricing policy chosen and adjustments made, including pricing formulas used, third party end-customer agreements, information

gathered, the arrangements represented by the quoted price, the details of the pricing formulae used, and detailed supply chain information.

In practical terms this brings with it a record keeping requirement, as it will often be necessary to retain sufficient records of individual transactions to demonstrate that the contractual pricing formula was applied and the data used to apply it.

Pricing date

The new guidance recognises that limited expertise and resources may exist within tax authorities in the commodity-dependent developing countries. One of the challenges faced in such situations relates to the difficulties in verifying the pricing date used, especially if the commodities-related contract allows for optionality in fixing the pricing date (rather than committing to a fixed date or other measure, such as rolling-average market prices) and in the absence of reliable evidence of the pricing date actually agreed.

The Final Report explicitly recognises the importance of third-party behaviour and data. This should allow taxpayers to defend the existing arrangements that are rooted in the third-party industry-specific behaviour, e.g., spot transactions that are always priced on the day of shipment (so there is no scope for manipulation) or term contracts (which use month averages or other quotational period triggered by observable events, such as a shipment date, arrival date, or laydays).

The Final Report goes a long way to specify clearly when the pricing date can be disregarded and explicitly requires tax authority to suggest any alternatives based on market data, as opposed to choosing dates that maximise the tax base.

Observations

The OECD has made a specific effort to preserve the consensus built around the arm's-length principle in relation to concerns from commodity-producing countries. However, the guidance needed to do so puts significant requirements on taxpayers in terms of understanding, analysing, and documenting complex commodity supply chains and pricing mechanisms. The OECD's request that taxpayers should release this data as part of documentation (as opposed to making this, often commercially sensitive information, available on request or on file) is likely to raise further questions about the sensitivity of some, highly confidential and valuable, pricing data.

This increased documentation burden, however, is an effort many taxpayers will undertake gladly as this allows them to price the commodities within their internal supply chain in the manner consistent with the arm's-length principle and market practice. For example, with respect to the commonly used references, this would include the use of commercial pricing periods, and using internal data for determining adjustment to market prices.

Accordingly, despite its brevity, it is likely the new guidance will be a subject of much debate and analysis, both by taxpayers, who are facing the end of the recent commodities "super cycle," and by the tax authorities, who remain keen to maintain the tax base affected by the recent decreases in the prices of their key export commodities.

Low value-adding intra-group services

The OECD also introduced its elective and simplified approach for low value-adding intra-group services into Chapter VII of the OECD Transfer Pricing Guidelines. These

modifications to Chapter VII have been developed in connection with Action Point 10 of the BEPS Action Plan, which is focused on developing rules to prevent BEPS by engaging in transactions that would not, or would only very rarely, occur between third parties, including adopting transfer pricing rules or special measures to provide protection against common types of base eroding payments, such as management fees and head office expenses.

The modifications to Chapter VII of the OECD Guidelines provide guidance on achieving the necessary balance between appropriately allocating to MNE group members charges for intra-group services in accordance with the arm's-length principle and the need to protect the tax base of countries in which entities are established that pay the service fee.

There are four areas in which the OECD provided additional guidance:

- Providing a definition of low value-adding intra-group services;
- Setting out an elective simplified approach for the determination of arm's-length charges for low-value adding intra-group services, including a simplified benefits test;
- Providing guidance on documentation and reporting requirements that should be met by an MNE group electing to apply the simplified approach; and
- Addressing issues with regard to the levying of withholding taxes on charges for low value-adding intra-group services.

Definition of “low value-adding intra-group” service

For the purpose of the simplified approach, low value-adding intra-group services are services performed by one or more members of an MNE group that (1) are supportive in nature; (2) are not part of the core business of the MNE; (3) do not require the use of unique and valuable intangibles and do not lead to the creation of such intangibles; and (4) 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.

The “supportive” nature of the low value-adding intra-group services basically means that such services should not constitute the core business of the MNE Group, although they can constitute the principal activity of an MNE group member – such as an IT service centre. From the perspective of such an IT service centre, the rendering of IT services is the company’s principal business activity, while it should not be the core business activity of the MNE group to qualify as a low value-adding intra-group service.

Intra-group services that typically would be captured by the definition include:

- Accounting and auditing.
- Processing and managing of accounts receivable, payable, etc.
- HR matters such as staffing, recruitment, training, remuneration services, etc.
- Monitoring and compilation of data relating to health, safety and environmental activities.
- IT.
- Public relations support activities.
- Legal and tax activities.

- General services of an administrative or clerical nature.

The OECD also identified a number of activities that would not be considered as low value-adding intra group services for purposes of the simplified approach. Such activities include (1) all services that constitute the core business of the MNE group; (2) research and development services (including software development unless falling within the scope of IT services referred to above); (3) manufacturing and production services; (4) purchasing activities relating to raw materials or other materials used in the manufacturing or production process, (5) sales, marketing, and distribution activities; (6) financial transactions; (7) extraction, exploration, or processing of natural resources; (8) insurance and re-insurance activities; and (9) services of corporate senior management.

The OECD clearly stipulates that the mere fact that an activity does not qualify for the simplified approach should not be interpreted to mean that that activity generates high returns. The activity could still add low value, and the determination of the arm’s-length charge for such activity should be determined according to the guidance set out in the other sections of Chapter VII.

Proposed simplified approach

The simplified charge mechanism put forth by Chapter VII for low value-adding intra-group services is premised on the proposition that all low value-adding service costs incurred in supporting the business of the MNE group members should be allocated to those members. The basic benefits of using the simplified approach include (1) reducing the compliance effort of meeting the benefits test and in demonstrating arm’s length charges; (2) proving greater certainty for MNE groups that

the price charged for the qualifying activities will be accepted by the tax administrations that have adopted the simplified approach when the conditions thereof have been met; and (3) providing tax administrations with targeted documentation enabling efficient review of compliance risk.

As far as possible, MNE groups electing to adopt the approach need to implement it on a group wide basis in all countries in which it operates.

In case MNE groups are being confronted with tax administrations that have not adopted the simplified approach, and the MNE group therefore complies with the local requirements of that jurisdiction, such local compliance would not disqualify the MNE group from the application of the simplified approach to other jurisdictions.

The simplified approach consists of the following five steps:

1. **Application of the benefit test to low value-adding intra-group services:** The OECD guidelines starts from the assumption that in case an MNE group has elected to adopt the simplified approach, tax administrations should refrain from reviewing or challenging the benefit test. Where the MNE group has followed the guidance on the simplified approach as regards documentation and reporting, this should provide sufficient evidence that the benefit test is met, given the nature of low value-adding intra-group services.

The benefit test needs to be considered by tax administrations on a category of services level only and not a specific charge basis. The taxpayer can thus limit its support by demonstrating that assistance for, e.g., payroll processing was provided, rather than being required to specify individual acts

undertaken that gave rise to the costs charged. Therefore, a single annual invoice describing a category of services should suffice to support the charge, and no other correspondence or evidence should be required.

2. **Determination of the cost pools** by calculating on an annual basis, a pool of all costs incurred by all members of the MNE group in performing each category of low value-adding intra-group services. The costs to be pooled are the direct and indirect costs of rendering the service as well as the appropriate part of operating expense. Costs need to be pooled according to the category of services and should identify the accounting costs centres used in creating the pool. Pass “through costs should be identified separately, and the pool should exclude costs that are attributable to an in-house activity benefiting solely the company performing the activity. From the pool, those costs that relate to a service performed by one member solely on behalf of another member need to be excluded.

3. **Allocation of the costs pool to the MNE group members** by means of allocation keys whereby the same allocation key must be used on a consistent basis for all costs of the same service category and which reasonably reflect the level of benefit expected to be received by each recipient of the service.

Allocation keys that are used as examples but are not put forward as the only possible keys in relation to the types of service mentioned include headcount for services related to people, total users for IT services, share of vehicles for fleet services, and share of assets or transactions for account support

services. Based on the guidance, turnover may be a relevant key for many cases.

Although the OECD states that more sophisticated keys might be used, a balance must be struck between “theoretical justification” and “practical administration,” bearing in mind that the costs to be allocated are not generating high value for the group. This also means that a single key could also be appropriate.

4. As regard the **profit mark-up**, a single mark-up should be utilised for all services irrespective of the category of service. The profit mark-up – which would function as a safe-harbour and thus not require to be supported by a benchmarking study – should be equal to 5% of the relevant cost base. This level of mark-up can only be applied to the category of services that fall within the “low value-adding” service definition and thus cannot be used as a benchmark for other categories of services not falling within the definitional scope. In addition, the Final Report makes it clear that the mark-up should not be applied to the portion of so-called “pass-through costs.”
5. The **total charge for low value-adding services** shall be the sum of (1) the costs incurred by an MNE group member for services rendered specifically to that group member by another group member plus the expected mark-up; and (2) that group member’s share of the pooled costs allocated to that member under step 3 above using the selected allocation key plus the selected profit mark-up.

An MNE group electing for the application of the simplified approach needs to prepare the following information and documentation and

make it available to the tax authorities upon request:

- A description of the categories of low value-added services provided; the identity of the beneficiaries; the reasons justifying that each category of services constitute low value-adding intra-group services within the definition set out; the rationale for the provision of services within the MNE; a description of the benefits or expected benefits of each category of services; a description of the allocation keys and the reasons justifying that such allocation key produce outcomes that reasonably reflect the benefits received and the confirmation of the mark-up applied;
- Written contracts or agreements;
- Calculations and documentation showing the determination of the cost pool and the mark-up applied thereon; and
- Calculations showing the application of the specified allocation keys.

The OECD also notes that tax administrations adopting the simplified approach may include an appropriate threshold to enable them to review the simplified approach in cases where the threshold is exceeded. This might, for instance, be based on fixed financial ratios of the recipient party or to be determined by reference to a group-wide ratio of total service costs to turnover of the MNE group or some other appropriate measure.

Levying of withholding tax on charges for low value-adding intra-group services

Finally, the OECD states that the levying of withholding taxes on these category of services can prevent the

service provider from recovering the totality of the costs incurred for rendering the services. Hence, when a profit element or mark-up is included in the charge of the services, tax administrations levying withholding tax are encouraged to apply it only to the amount of that profit element or mark-up.

Cost contribution arrangements

The OECD's now finalised detailed guidance on CCAs takes the form of Revisions to Chapter VIII of the OECD Transfer Pricing Guidelines. The principles of the guidance and the underlying messages remain largely unchanged and continue to focus on appropriate valuations of the contributions and benefits of CCAs to ensure that contributions are commensurate with expected benefits to be received under the CCA. The overarching theme of the guidance on CCAs is that parties performing activities under arrangements with similar economic characteristics should receive similar expected returns regardless of the existence of a CCA.

The concept of CCAs

The addition to paragraph 8.3 clarifies that CCAs are meant to be operationally realistic, as transfer pricing issues focus on the relationship between participants but do not require participants otherwise to combine or alter their operations in exploiting any intangibles arising from the CCA. Paragraph 4 further describes the analysis to be undertaken for a CCA, concluding that irrespective of the existence of a CCA, parties performing activities under arrangements with similar economic characteristics should receive similar expected returns.

Paragraph 8 was added to offer an example of a scenario where a CCA can simplify multiple transactions in which associated enterprises both

perform activities for other group members and receive beneficial services from other group members. CCAs in such a scenario may make operational sense to replace the web of separate intra-group payments with a streamlined structure of net payments based on aggregate benefits.

In the example, a CCA allows the entities to avoid the operational difficulties of a cross-licensing structure. This result is aligned with the concept that the participants of a CCA should be in an economically equivalent position to otherwise similar parties undertaking the same transaction without a CCA, although a CCA structure may streamline or alter the operational efficiencies of the transaction(s). This is reinforced in paragraph 8.9 which states that the analytical framework for reviewing transfer prices for CCAs is the same as analysing other forms of contractual relations.

This Final Report continues to emphasize important functions in relation to the development, enhancement, maintenance, protection, and exploitation of the intangibles, but in many cases it is arguably the application of the "options realistically available" concept that is more telling in determining the value of the contributions. This concept is used in the Final Report to dictate that a participant only providing funding should receive a limited return, raising concerns regarding consistency with the arm's length principle. No practical guidance is currently available as to how these approaches are to be reconciled, or how "control" functions might be valued on an arm's-length basis, while it is recognised that it can be "difficult" to measure contributions that involve shared property or services. Accordingly, the actual implementation and management of

CCAs is likely to increase in complexity and lead to controversy.

Development CCAs versus Service CCAs

Paragraph 8.10 adds additional description around Development CCAs, noting that they often involve significant risks associated with uncertain and distant benefits. In addition, participants in Development CCAs agree to share the upside and downside consequences of risks associated with achieving the anticipated CCA outcomes. Service CCAs, on the other hand, are generally less risky and offer more certainty.

This additional description was added to highlight the extra guidance that may be required with regard to Development CCAs. While the Final Report has a heightened focus on Development CCAs, which is also a concentrated effort of OECD Countries such as the United States, there is less of a focus on Services CCAs, which continue to be a prevalent MNE arrangement and deserve similar attention in this regard.

Determining participants in a CCA

The proposed requirement in the Discussion Draft that a participant in a CCA must have the capability and authority to control the risks associated with the "risk-bearing opportunity" under the CCA is maintained in the Final Report. While consistent with the overall theme of the BEPS project of focusing on "substance," this requirement is a paradigm shift for CCAs.

In order to be a participant in a CCA, a party must exercise control over the specific risks it assumes under the CCA. In addition, it must have the financial capacity to assume these risks, including the capability to decide to undertake risk-bearing opportunities and the capability to

make decisions on whether and how to respond to the risks associated with the opportunity as well as perform the decision making function.

Nevertheless, paragraph 8.17 notes that it is not necessary for all CCA activities to be performed by the personnel of CCA participants. Thus, participants in a CCA may outsource certain functions to a separate entity outside the scope of the CCA. In such a scenario, the relevant CCA participants must exercise the requisite control over the specific risks they assume under the CCA.

The value of contributions

The Final Report modifies the Discussion Draft's attempt to offer more flexibility with the aim toward simplification. A distinction is drawn between contributions of pre-existing value and current contributions. For example, the contribution of patented technology to be used in the development of an intangible would reflect the contribution of pre-existing value, whereas the contribution of current R&D would constitute a current contribution. The Final Report emphasizes that the value of the pre-existing intangible (e.g., patented technology) should be determined under the arm's-length principle using guidance in Chapter I-II and Chapter VI, including the valuation techniques as set out in Chapter VI.

In an attempt to offer simplification, the Final Report allows the value of the current contribution (e.g., R&D) to be based on cost. If this approach is taken, the pre-existing contributions should recover the opportunity cost of the ex-ante commitment to contribute the resources to the CCA.

This concept of current contributions reimbursed at costs (with any requisite compensation to the contributor of the pre-existing contributions) replaces the concept of

“low value-added services” included in the Discussion Draft. In so doing, the Final Report replaces the “scenarios where the difference between value and costs is relatively modest” with “scenarios where the difference between value and costs is relatively insignificant.” Such a slight change provides little certainty and is likely to result in similar line drawing issues of what can be considered insignificant.

The Final Report emphasizes that care should be taken in comparing CCAs of associated enterprises and those of uncontrolled taxpayers when contributions are made at cost. It is important to consider the comparability of all the economically relevant characteristics of the transactions in the broader context of the relationship between the relevant parties and to review the economics and sharing of risks of any related arrangements that may exist between the parties to the uncontrolled transaction.

Balancing payments

A balancing payment may be necessary where the value of a participant's share of overall contributions under a CCA at the time the contributions are made is not consistent with the expected benefit to be received by the participant. The Final Report states that a balancing payment may be necessary where the value of a participant's proportionate contribution at the time of contribution was incorrectly determined, or where the participant's proportionate expected benefits were incorrectly assessed.

Significant balancing payments arising from a material difference between the participant's proportionate share of contributions and benefits may bring questions to the structure of the CCA and whether the arrangement should be delineated as a funding transaction. From a US perspective, however, if balancing

payments are designed to re-allocate profits from cost-shared intangibles, this would be a significant and material departure from the US cost sharing arrangement rules. The US rules provide a safe harbour for taxpayers to ensure that so-called balancing payments are not needed; instead, a reallocation of the cost shared amounts is made to reflect benefits received.

Coordination with Masterfile and local file

Paragraph 8.51 connects CCAs and Masterfile requirements, noting the transfer pricing documentation standard set out in Chapter V requires reporting under the Masterfile of important service arrangements and agreements related to intangibles, including CCAs. Furthermore, the local file requires transactional information, including a description of the transactions, the amounts of payments and receipts, identification of the associated enterprises involved, copies of material intercompany agreements, and pricing information, including a description of reasons for concluding that the transactions were priced on an arm's-length basis. Paragraph 8.51 thus notes that it would be expected that in order to comply with these documentation requirements, the participants in a CCA will maintain materials describing the arm's-length nature of the CCA. Notably, the Final Report states that the level of detail of the materials prepared should be commensurate with the complexity and importance of the CCA to the taxpayer.

Summary

The release of the CCA guidance should be welcomed as ensuring a consistent transfer pricing approach to CCAs and related-party transactions. As such, the Final Report is important in protecting the

consensus built around the arm's-length principle.

The revised wording has clarified the OECD's intention in a number of areas, allowing taxpayers more certainty and potential simplification with the use of CCAs. Additional guidance on development CCAs may provide additional certainty to taxpayers.

The takeaway

The transfer pricing topics covered in BEPS Actions 8 to 10 provide significant and definitive guidance for tax authorities and MNEs on the fundamentals of the arm's-length

principle, including reward for risk and control, intangibles, commodity transactions, low-value add services, and cost contribution arrangements. Although the Final Report has been released and is fully incorporated into the Transfer Pricing Guidelines, work on BEPS will continue into 2016 and beyond including financial transactions, attribution of profits to permanent establishments, and other specified areas noted above, as well as the implementation and monitoring of the Final Report.

While the OECD has delivered a large volume of final reports within a tight schedule, the lack of definitive

guidance on use of profit split methods creates uncertainty for MNE's with global value chains. In response, taxpayers should review their transfer pricing policies, focusing on whether the substance of their activities is aligned with the location of profits. As reliance solely on legal contracts no longer will be sufficient, thorough functional analyses with specific focus on the parties' behaviour should be conducted to support the delineation of intercompany transactions, particularly for entities that earn a return for setting group strategy.

Let's talk

For a deeper discussion, please call your local contact. If you don't have one or are not sure who to speak to on a global level, the people below listed by BEPS Action Plan area will be pleased to help you.

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