OECD releases updated Transfer Pricing Guidelines, additional guidance on Country-by-Country Reporting

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In brief

On July 10, 2017, the Organisation for Co-operation and Economic Development (OECD) released the 2017 edition of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the Guidelines). The 2017 edition incorporates a number of revisions the OECD has made to the Guidelines as part of its base erosion and profit shifting (BEPS) project since their last publication in 2010.

Specifically, the 2017 edition includes revisions introduced under BEPS Actions 8-10 (Aligning Transfer Pricing Outcomes with Value Creation) and 13 (Transfer Pricing Documentation and Country-by-Country (CbC) Reporting), revised guidance on safe harbors, and conforming changes to other parts of the Guidelines.

Additionally, on July 18, 2017, the OECD released additional updated guidance on the implementation of CbC reporting under BEPS Action 13 (the CbC guidance). Action 13 is one of the four BEPS Actions that contain "minimum standards," and CBC reporting is a recommendation that all countries in the OECD, as well as many other countries, have committed to implement or already have implemented.

Previously updated in December 2016 and April 2017, the CbC guidance now addresses the treatment (for CbC reporting purposes) of an entity owned by two or more unrelated MNE Groups, and whether aggregated or consolidated data should be reported on Table 1 of the CbC report. For our prior coverage of the CbC reporting guidance, please see our Tax Insight discussing the April 2017 update.

In detail

Key items in 2017 edition of Guidelines

The updated Guidelines incorporate a number of important international tax policy decisions that have been made over the course of the BEPS Project.

Actions 8-10 (Aligning Transfer Pricing Outcomes with Value Creation). The revisions made in line with Actions 8-10 generally pertain to Chapters I (The Arm's Length Principle), II (Transfer Pricing Methods), VI (Special Considerations for Intangibles), VII (Special Considerations for Intra-Group Services), and VIII (Cost Contribution Agreements) of the Guidelines. The OECD also made conforming changes to

Chapter IX (Business Restructurings), as well as other areas of the Guidelines.

The following are some key takeaways from these revisions:

- 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.
- Although legal agreements continue to serve as a starting point, returns from intangibles accrue to the entities that carry out the development, enhancement, maintenance, protection, and exploitation (DEMPE) 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 harbor of five percent is established for low-value-adding intra-group services.
- Cost Contribution Agreement (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 based on the principles of Chapters I, II, and V of the Guidelines.
- For an in-depth discussion of these revisions, please see our Tax Insight discussing the Actions 8-10 Final Report.

Action 13 (Transfer Pricing Documentation and CbC Reporting). The OECD's efforts under Action 13 have significantly increased transfer pricing compliance burdens as well as transparency; as a result, multinational entities face significantly higher disclosure obligations in many jurisdictions. The revisions made under Action 13 generally pertain to Chapter V (Documentation) of the Guidelines. Importantly, Chapter V now includes a discussion of the OECD-favored three-tiered approach to transfer pricing documentation (i.e., master file, local file, and CbC report). For an in-depth discussion of these revisions, please see our January 28, 2016 Tax Policy Bulletin.

Safe harbors. The revisions regarding safe harbors generally pertain to Chapter IV (Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes) of the Guidelines. Strategically designed safe harbors, eventually complemented with a network of memoranda of understanding, should allow for a more balanced approach to compliance efforts in a world where an increasing number of jurisdictions have adopted transfer pricing documentation requirements and multinational enterprises extend their global operations. For an in-depth discussion of these revisions, please see our May 28, 2013 Tax Controversy and Dispute Resolution Alert.

Conforming changes. The revisions also include conforming changes to Chapter IX (Business Restructurings), the Foreword, the Preface, the Glossary, and the various Annexes.

Updated CbC Reporting guidance

The updated Guidance on the Implementation of CbC Reporting represents the complete set of published OECD guidance related to CbC reporting (issued June 2016, and updated December 2016, April 2017, and July 2017). Specifically, this updated document now addresses:

- How to treat an entity owned and/or operated by two or more unrelated MNE Groups; and
- Whether aggregated data or consolidated data for each jurisdiction is to be reported in Table 1 of the CbC report.

Multiple MNE groups. Whether an entity owned and/or operated by more than one unrelated MNE Group is considered a Constituent Entity of either MNE Group should be determined under the accounting rules separately applicable to each unrelated MNE Group. Thus, if the applicable accounting rules require an entity to be consolidated into the consolidated financial statements of an MNE Group on a full or pro-rata basis, the entity would be considered as a Constituent Entity of that group and the financial data of the entity should be reported in the CbC report of the MNE Group. An entity included in a MNE Group's consolidated financial statements under equity accounting rules would not be a Constituent Entity.

The CbC guidance further provides that jurisdictions may allow a pro-rata share (rather than the full amount) of an entity's total revenue to be taken into account for purposes of applying the CbC reporting threshold in cases where pro-rata consolidation is applied to the entity. In a similar vein, the CbC guidance provides that jurisdictions may allow a pro-rata share of such an entity's financial data to be reported in the MNE Group's consolidated financial statements.

This guidance applies in the case of a joint ventures, but also may be applied where entities have been acquired or disposed of during the reporting fiscal year.

Aggregated or consolidated data. While the Action 13 Final Report and the model legislation contemplate aggregate-basis reporting, jurisdictions allowing for consolidated tax reporting may allow for a CbC report to be filed using consolidated data, provided, however, that the consolidated data are reported for each jurisdiction in Table 1 of the CbC report and consolidation is used consistently across the years.

Where the use of consolidated data is expressly permitted by a tax authority, a taxpayer opting to report consolidated data should use the following wording in Table 3 of the CbC report: "This report uses consolidated data at the jurisdictional level for reporting the data in Table 1." Furthermore, the taxpayer should specify the columns in Table 1 in which the consolidated data are different than if aggregated data were reported.

The CbC guidance contemplates that jurisdictions will permit some flexibility during a transition period (i.e., for fiscal years beginning in 2016) to allow for MNE Groups to make the necessary adjustments for reporting aggregated data where tax authorities may have indicated consolidated data were permissible, but their guidance is inconsistent with the OECD's conditions for using consolidated data.

Observation

We understand that the United States and most other countries that have implemented CbC reporting do not provide for consolidated reporting for tax purposes, whereby 'the consolidation eliminates intra-group transactions at the level of individual line items.' As a result, this latest clarification is anticipated to have relatively little impact on MNEs and their CbC reporting obligation. We further understand that the US Internal Revenue Service will clarify in the CbC reporting FAQ on its website that the United States will not permit the use of consolidated data.

The takeaway

While the individual revisions incorporated in the 2017 edition of the Guidelines previously had been published in the BEPS drafts and final reports (most of which were published in 2015), the incorporation of these revisions (and the conforming changes) into a single document may further encourage tax authorities to take a more aggressive stance toward MNEs, and even to seek to apply these changes retroactively. As a result, we encourage you immediately to (1) evaluate your "risk" management paradigm; (2) update any intercompany agreements that no longer align with practice (or reinforce/re-educate your businesses on acceptable policies/practices); and (3) consider how the new DEMPE guidance affects your IP transfer pricing policies, and, analogously, your financial transactions transfer pricing policies.

The OECD continues to clarify issues left unanswered in the Final Action 13 Report released in late 2015. However, as the due date for many MNEs is quickly approaching, we believe that the OECD's suggestion for some flexibility for MNE Groups in meeting their newly clarified CbC reporting requirements should be stronger and applied more broadly (perhaps to any clarification made within six months of an MNE's filing deadline).

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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