

TRANSFER PRICING

RECENT DEVELOPMENTS AT THE OECD

**John Neighbour, Head, Tax Treaty,
Transfer Pricing and Financial
Transactions (TTP) Division.**

TRANSFER PRICING

- **Monitoring the Guidelines**
- **Electronic Commerce**
- **Attribution of Profit to a PE**
- **Dispute Resolution**
- **Involvement of Non-OECD Members**
- **Arm's Length Principle**

1995 GUIDELINES

- **Developed by Working Party 6**
- **Arm's length principle**
- **Process of monitoring, clarifying and updating**
- **Dynamic: Must cope with change**
- **Flexible: Must cope with a vast range of transactions**

MONITORING

- **Updates on country legislation and developments.**
- **Development of examples and difficult case paradigms: Use of multi-year data; risk; marketing intangibles.**
- **Country and issue reviews: Transactional profit split method and TNMM.**

ELECTRONIC COMMERCE

- **Technical Advisory Groups (TAGs)**
- **Business Profits TAG**
- **“Attribution of Profit to a PE Involved in Electronic Commerce”**
- **“Impact of the Communications Revolution on the Application of “Place of Effective Management” as a Tie Breaker Rule”**

STARCO EXAMPLE

- **Internet e-tailer**
- **Sells music and video products either physically or by electronic online delivery**
- **Web site on a server owned by the enterprise (and constitutes a PE)**
- **The web site promotes and details the products, receives customer orders, processes payments and performs on-line delivery.**

STARCO: 4 VARIATIONS

- **Stand alone server; no personnel**
- **Multiple servers in a number of jurisdictions**
- **Personnel present to perform routines functions regarding the server**
- **Existing PE which developed the software used by the server in performing its functions**

STARCO: ANALYSIS

- **Factual analysis to determine functions performed, assets used and risks assumed.**
- **Identify dealings between PE and other parts of the enterprise and apply the arm's length principle**
- **determine the profit to be attributed to the hypothesised separate enterprise based on comparability analysis.**

STARCO: FUNCTIONS

- **Portal into the web**
- **Presentation and promotion**
- **Processing of orders and payments**
- **Transmission of digital products**
- **Assets used: hardware and software**
- **Risks assumed: not much**
- **Many sales functions NOT performed.**

STARCO: PROVISIONAL CONCLUSIONS

- **Not equivalent to a distributor or retail outlet**
- **More akin to a “contract service provider” or an “independent service provider”**
- **ISPs as comparables?**
- **Only in variation 4 is PE entitled to return earned by use of software.**
- **Variation 4 - developed the software and thus assumed the risk of development.**

ELECTRONIC COMMERCE

Details of the Committee's conclusions and recommendations can be found on the OECD's website at

<http://www.oecd.org/daf/ctp/ce>

ATTRIBUTION OF PROFIT TO A PE

Discussion Paper:

- **Discussion Draft on the Attribution of Profits to Permanent Establishments**
- **Part I: General Considerations**
- **Part II: Special Considerations for Applying the Working Hypothesis to Banks**
- **Still to come: Parts III (Global Trading) and IV (Insurance)**

WORKING HYPOTHESIS

Profits to be attributed to a PE are the profits that the PE would have earned at arm's length as if it were a separate enterprise performing the same functions under the same or similar conditions, determined by applying the arm's length principle under Article 7(2)

Attribution of Profit to a Permanent Establishment

Purpose: Towards achieving a consensus position on the attribution of profit to a PE under Article 7.

Working Hypothesis: the preferred approach.

- **Functional and factual analysis to hypothesise the PE as a distinct and separate enterprise**
- **Application of the arm's length principle to the hypothetical enterprise in accordance with the 1995 Guidelines**

SPECIFIC ISSUES

- **Identify dealings and apply ALP**
- **Intangible property: how recognise the use of intangible property?**
- **Internal services: has a service been provided? Arm's length price?**
- **Capital allocation and funding**

BANKS

Allocate regulatory capital between parts of the enterprise in proportion to risk weighted assets.

DISPUTE RESOLUTION

- **Major concern to business**
- **Existing guidance: in Guidelines and Commentary to Article 25**
- **Existing guidance: workings of MAP; corresponding adjustments; MAP APAs**
- **Scope for further work: improve working of MAP; co-operation between authorities; mediation and arbitration.**

FUTURE

- **Involvement of non OECD members desirable and essential**
- **Global Forum**
- **Training**
- **Technical assistance**
- **Explore ways in which non-members can associate with the 1995 Guidelines**

ARM'S LENGTH PRINCIPLE

- **Pressures on the arm's length principle:**
- **Efficiencies arising from economies of scale**
- **Integrated supply chain and support activities. Fewer comparables**
- **Globally integrated business: same business carried on by a number of related entities.**

ARM'S LENGTH PRINCIPLE

Can it cope?

- **Availability of comparable information in different form**
- **Guidelines flexible and dynamic to cope with change**
- **Use of profit split method**
- **More industry specific guidance**
- **No alternatives.**