Transfer Pricing News
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OECD releases 2010 transfer pricing guidelines

The Transfer Pricing Group is a Pan-European working group of transfer pricing specialists and provides assistance to organizations and companies. The Transfer Pricing Group strives to understand the client's business objectives and deliver tailor made transfer pricing solutions. The high quality of communication, thanks to frequent cross border conference calls and meetings, is a key feature and builds a strong working relationship, brings fresh perspectives and the early identification to emerging issues.

The European transfer pricing group works closely together with dedicated teams of tax professionals and economists of member firms of RSM International based in global major business centres such as North America and Asia Pacific to provide seamless service wherever the client's businesses are.

On July 22, 2010 the OECD published its long expected 2010 revision of the transfer pricing guidelines which have been the main source of reference in the field of transfer pricing for tax legislators, revenue services and tax advisors around the world since 1995. Chapters I, II and III have been revised entirely and a new chapter has been added on the transfer pricing aspects of business restructurings (Chapter IX).

The new guidelines contain important changes that will have a significant impact on the way in which transfer pricing projects are carried out, especially with respect to business restructurings. Please find below a short summary of the most important changes that are included in the 2010 revision of the OECD transfer pricing guidelines and a short analysis of their practical impact.

Selection of transfer pricing methods

Under the previous OECD guidelines, transactional profit methods such as the commonly used Transactional Net Margin Method (TNMM) and the Profit Split method were in principle considered methods of last resort. The new version of the transfer pricing guidelines however prescribes a "most appropriate" approach, which implies that the TNMM and the Profit Split are no longer considered "inferior" methods. The only hierarchical element that remains between the various methods is the preference for the Comparable Uncontrolled Price (CUP) method.

As a result of the fact that in practice CUPs are often not available, for instance due to differences in volume or other conditions between related and unrelated transactions within the same enterprise, as well as the increased recognition of the transactional profit methods under the 2010 OECD guidelines, an even further increase of the use of these methods can be expected, especially when it concerns the Profit Split method.

Increased guidance on comparability analyses

Another reason why growth in the use of transactional profit methods can be expected is that the new OECD guidelines provide more guidance on the selection or rejection of comparables (which in practice are often retrieved from databases) as well as on the selection of the tested party, the use of interquartile ranges and how to deal with extreme results (so-called "outliers").

Transfer pricing aspects of business restructurings

Business restructurings, which are defined as "the cross-border redeployment by a multinational enterprise of functions, assets and/or risks" are now discussed extensively in the entirely new Chapter IX. As a higher risk profile normally entails a higher reward, taxpayers often try shifting risks to low-taxed jurisdictions. Considering the transfer pricing discussions contained in the new guidelines, such restructurings will in many cases require even more careful implementation than under the previous guidelines.

An important element is the observation that a contractual reallocation of risk between associated enterprises will be respected only to the extent that it has economic substance. Whether an allocation has economic substance depends on whether the conduct of the associated enterprises conforms to the contractual allocation of risks, whether this allocation is at arm's length and what the consequences of this risk allocation are. If an allocation of risk lacks economic substance, tax authorities may decide to disregard the restructuring. An important aspect in determining the economic substance of an allocation of risk is whether a certain party has "control" over this risk. In practice this means that a company should have people (employees or directors) who have the authority to perform these control functions and effectively do so. This implies that a party who contractually bears a risk but hires a third party to administer and monitor this risk on a day-to-day basis, will not be considered to have control over this risk. In such a case, tax authorities may decide to ignore a restructuring.

Another important new element is the discussion on compensations for a change in risk profile of a company (and therefore its profit potential), for instance from a full-fledged manufacturer to a contract manufacturer. Although independent enterprises would not necessarily receive compensation for a reallocation of risks and profit potential, it is important to consider whether this reallocation would also have been agreed upon between independent parties in the particular situation. The answer to this question depends for instance on the market conditions, its anticipated arm's length reward before and after the restructuring and its level or risk tolerance. Under certain conditions, the arm's length principle may require a compensation for a shift in profit potential.

Observations

The revised transfer pricing guidelines will in many cases provide a powerful tool for tax authorities to challenge the earlier envisaged tax implications of business restructurings carried out in the past. Since many governments around the world are struggling with budget deficits, tax authorities can be expected to review existing transfer pricing documentation and (if possible) apply corrections in situations where this would be favourable to them. Therefore it is recommendable to carefully plan cross-border restructurings and to check whether legal agreements and reorganizations in the past are sustainable in the light of the new OECD transfer pricing guidelines.

On the other hand, the 2010 OECD transfer pricing guidelines provide practical guidance for many common issues encountered in the current transfer pricing practice. Especially the new guidance on the use of transactional profit methods and how to deal with business restructuring will prove to be very useful in practice. Therefore, the revised transfer pricing guidelines also provide new opportunities for multinational companies for reviewing and optimizing their existing transfer pricing policies.

Fore more detailed information, please do not hesitate to contact your local RSM contact person or a member of the RSM Centre of Excellence on Transfer Pricing

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