ACTION POINTS ON TRANSFER PRICING

U.S. VIEW

O.E.C.D. INITIATIVE

TRANSFER PRICING

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Overview

Action	Description
8. Assure transfer pricing outcomes are in line with value creation: intangibles	Identify main difficulties that the digital economy poses for the application of existing international tax rules.
9. Assure transfer pricing outcomes are in line with value creation: risks and capital	Develop rules to prevent BEPS by transferring risks among or allocating excessive capital to group members.
10. Assure transfer pricing outcomes are in line with value creation: other high-risk transactions	Develop rules to prevent BEPS by engaging which would not or rarely occur between third parties.
11. Re-examine transfer pricing documentation	Develop rules regarding transfer pricing documentation to enhance transparency for tax administration.

Key Points

- Prevent "Land Grab": I.R.S. trying to prevent other countries from encroaching on revenue that it believes belongs to U.S.
- Prevent Increased Documentation that is not relevant: I.R.S. content with information it is receiving from U.S. so far. Implicitly suggesting that it is against O.E.C.D's wish for increased documentation?
- I.R.S. Content With Valuation of I.P: I.R.S. trying to prevent different valuation techniques of intellectual property.
- Arms Length Principle Kept To Avoid "Land Grab": Important priority for the I.R.S. is to protect "arms length principle"

B.E.P.S. & Group Members

- Really a viewpoint from the I.R.S. (bilateral approach) v. O.E.C.D. (multilateral approach).
  - **Multilateral Approach Preferred but Rare To Implement:** While the I.R.S. applauds the OECD's attempt to put all the issues on the table, it believes that most of the solutions will come on a country by country basis rather than a multilateral basis.
  - The I.R.S. would rather have a multilateral discussion rather than a multilateral approach.
  - **See: Article 5: Permanent Establishment:** The I.R.S. thinks that the OECD's attempt to reach a consensus is nice but unfortunately, each country acts differently and operates in ways in which they think they know what the right answer is as to what a P.E is.

Action Point 8: Outcomes=Value Creation—Intangibles

- Goal: Prevent movement of intangibles by:
  - Adopting delineated definition of intangibles;
  - Accord profits with transfer/use of intangibles in accordance with value creation;
  - Develop transfer pricing rules to value “hard to value” intangibles;
  - Update guidance of cost contribution agreements.

Action Point 8: Outcomes=Value Creation—Intangibles

- **B.E.P.S. Site Income To "Relevant People Functions":** B.E.P.S attempts to site income from intangibles to the location of the relevant people functions -- development, care, and supervision of intangibles since it is unlikely there will be people functions in intellectual property holding companies in tax havens

- **I.R.S. Focus on Intangibles Project:** The I.R.S. is focused on its own intangible project. The U.S. is assisting with a plan with respect to intangibles and the O.E.C.D. and expects B.E.P.S. to help fill in the gaps and supplement it.
  - **Valuation Done Ex Ante:** I.R.S. wants to ensure that that the general principle holds that the valuation of transfer pricing is done on an ex ante basis.

- **Arm's Length Procedure Should Be Kept:** The I.R.S. will resist any attempt from the OECD and BEPS to weaken the arms length transaction principle. Seems that O.E.C.D. is complying with U.S. viewpoint
  - U.S. has no objections to B.E.P.S. viewpoint on C.F.C.s and hybrids but will maintain focus on arms length principle.

- **Value Creation v. Arms Length Principle:** Although the I.R.S. has not admitted as much, commentators believe that "value creation" will come into conflict with the "arms length principle".

- **Audit Approach:** B.E.P.S. seeks to distance itself from the "audit approach" which may hurt the U.S. The I.R.S. has not commented on this issue…yet.

Action Point 9

- Goal: Ensure that inappropriate income returns do not accrue to an entity solely because it has contractually assumed risks or provided capital.
  - "Inappropriate" and "solely" key words.
  - Align returns with value creation.
  - Hand-in-hand with Action Point 10 which characterizes related party transactions.

Action Point 10

- Goal: Prevent transactions that do not occur, or only rarely occur, between third parties.
- This will involve adopting transfer pricing rules or special measures to:
  - Clarify the circumstances in which transactions can be recharacterized;
  - Clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and
  - Provide protection against common types of base eroding payments, such as management fees and head office expenses.

Action Point 10→Analysis

- Current Rule: Respects transaction as structured, which leads to certainty and predictability
- New Rule: Related party transactions must have economic substance While related party transactions must have economic substance to be respected as structured, it has long been understood that related party transactions do not need to conform to the terms of actual unrelated party transactions to have economic substance
- U.S. v. B.E.P.S.: Management Fees and Head Office Expenses as Base Eroding:
  - As a country with an abundance of head offices, the U.S. views these expenses as base protecting, not base eroding, contrary to B.E.P.S.' opinion.

Documentation→Article 11

- **Documentation: Article 11: Information Reporting on Companies:**
  - (U.S.) Issue Based Approach v. (O.E.C.D.) Master File
  - Master File—O.E.C.D v. I.R.S.: The O.E.C.D wants a master file in case regulators want to review and investigate past decisions. While the I.R.S. is claiming they would like more information than the O.E.C.D, the I.R.S. is leaning against using a master list based on cost and utility.
  - Compulsory Exchange On Rulings Related to Preferential Regimes and Required Business Substance for Preferential Regimes. Also emphasized is the proposal for taxpayers to disclose their aggressive tax planning arrangements. This proposal is similar to the I.R.S. schedule UTP for reporting on U.S. federal uncertain tax positions as described in §6011 and is likely welcomed by the I.R.S.

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