

B.E.P.S. ACTIONS 8, 9 & 10: ASSURING THAT TRANSFER PRICING OUTCOMES ARE IN LINE WITH VALUE CREATION

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Tags

Action 8
Action 9
Action 10
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B.E.P.S.
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Risk
Transfer Pricing

On December 19, 2014, the Organisation of Economic Co-operation and Development (“O.E.C.D.”) released a discussion draft on Actions 8, 9, and 10 of the Base Erosion and Profit Shifting (“B.E.P.S.”) Action Plan (“Discussion Draft” or “Draft”)¹. Actions 8, 9, and 10 reinforce the goal of assuring that transfer pricing outcomes are in line with value creation.

In July 2013, the O.E.C.D. published the B.E.P.S. Action Plan for the purpose of establishing a comprehensive agenda to resolve B.E.P.S. issues. The B.E.P.S. Action Plan identifies 15 actions to combat B.E.P.S. and establishes deadlines for application of each action.

The Discussion Draft introduces revisions to Chapter I of the Transfer Pricing Guidelines and addresses the related topics in Actions 8, 9, and 10. Specifically, the Discussion Draft focuses on the development of the following:

- (i) rules to prevent B.E.P.S. by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation.
- (ii) rules to prevent B.E.P.S. by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterized.
- (iii) transfer pricing rules or special measures for transfers of hard-to-value intangibles.

The Discussion Draft establishes guidance on these risk and recharacterization issues in two parts. Part I consists of proposed revisions to Section D of the Chapter I Transfer Pricing Guidelines and focuses on accurately defining the actual transactions and allocating of risk. Part II introduces a framework of questions along with five potential options for special measures relevant to intangible assets, risk, and over-capitalization.

The revisions to Section D, discussed in Part I of the draft, focus on the application of the arm's length principle and provide detailed guidance on determining the economically relevant characteristics or comparability factors of the controlled

¹ O.E.C.D. (2014) [“BEPS Actions 8, 9, and 10: Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines \(Including Risk, Recharacterisation, and Special Measures\)”](#)

transaction. The revisions also establish criteria on when an actual transaction should not be recognized or be recharacterized. Part I stresses the importance of:

(i) the accurate delineation of the actual transaction based on both the contractual arrangements and the conduct of the parties, (ii) the specification of associated risks and allocation of risk to risk management, and (iii) the non-recognition of transactions which lack the fundamental attributes of arrangements between unrelated parties, for purposes of matching where profits are reported and where value is created.

These issues are identified by the Discussion Draft as “giving rise to several issues at the heart of the arm’s length principle.” In this context, additional points are raised by the Discussion Draft to be taken into consideration for comments, these include “moral hazard” (*i.e.*, the lack of incentive to guard against risk where one is protected from its consequences), “risk-return trade-off” (*i.e.*, the inclination to take on or lay off risk in return for higher or lower anticipated nominal income), and whether or not distinctions should to be made in applying the guidance to the financial sector.

Part II outlines potential special measures pertaining to intangible assets, risk, and over-capitalization. These special measures are either within or beyond the scope of the arm’s length principle. The primary aims of these special measures are to ensure that transfer pricing outcomes are in line with value creation and to limit the risk of B.E.P.S. for governments.

The special measures are introduced through the following five options:

- Option 1 addresses hard-to-value intangibles;
- Option 2 addresses issues with regard to an independent investor;
- Option 3 addresses thick capitalization;
- Option 4 addresses determination of a minimal functional entity;
- Option 5 addresses appropriate taxation of excess returns.

The situations proposed in these options closely relate to Action 3 (on strengthening the controlled foreign corporation [“C.F.C.”] rules) and Action 4 (on interest deductions). According to the Draft, some of the measures are closely related to C.F.C. rules or “can be seen as [C.F.C.] rules.” The Discussion Draft explains that such measures were included in order to obtain public comments in this respect prior to the public consultation on C.F.C. rules, which is planned for April 2015. The Draft also contains a series of ten questions that serves as a framework for determining whether and how each option should be implemented in order to achieve the transfer pricing goals of the B.E.P.S. Action Plan.

The views and proposals included in the Discussion Draft do not represent consensus views of the Committee on Fiscal Affairs or its subsidiary bodies but are intended to provide stakeholders with substantive proposals for analysis and comments. Accordingly, the O.E.C.D. invites the public to submit written comments on the Discussion Draft by February 6, 2015. There will also be a public consultation on the Discussion Draft and other topics on March 19th and 20th at the O.E.C.D. Conference Centre in Paris.

