B.E.P.S. ACTION 10 – PART II: THE TRANSFER PRICING ASPECTS OF CROSS-BORDER COMMODITY TRANSACTIONS

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The discussion draft on Action 10 (the "Discussion Draft")[1] deals with transfer pricing issues in relation to commodities transactions and the potential for Base Erosion and Profit Shifting ("B.E.P.S."). The commodity sector constitutes major economic activity for developing countries and provides both employment and government revenue.

In seeking to create clear guidance on the application of transfer pricing rules to commodity transactions, the Discussion Draft identifies several problems and policy challenges and seeks to establish a transfer pricing outcome that is in line with value creation.

PROPOSALS TO CHAPTER II OF THE TRANSFER PRICING GUIDELINES

The Discussion Draft identifies issues and invites commentary on the *O.E.C.D. Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (the "Transfer Pricing Guidelines")[2] as follows:

- *Use of the C.U.P. Method* – the Discussion Draft identifies the Comparable Uncontrolled Price ("C.U.P.") method as the appropriate transfer pricing method for establishing an arm's length price. Some adjustments will be required when the "quoted price" relates to a commodity that is not similar in terms of physical features and quality. The application of the C.U.P. method should be documented in writing to assist tax authorities in carrying out an informed examination. The documentation should provide the price-setting policy and other relevant information related to the pricing of the commodity.
- *Deemed Pricing Date for Commodity Transactions* – Sometimes there is a significant delay between the date of entering into a contract and the date of delivery. During this time, the price of the commodity fluctuates, and it is often difficult for the tax administration to verify the pricing date. The Discussion Draft proposes the use of a "Deemed Pricing Date" for commodity transactions. The related parties may select the Deemed Pricing Date for the commodity, but if the evidence pertaining to this date contradicts the facts of the case, the tax authorities may impute the price date based on the evidence provided by the related parties. If reliable evidence does not exist, the date of shipment will be treated as the pricing date. This provision has the potential to wreak havoc on a business model that uses a forward price on an earlier

[1] O.E.C.D. (2014), "BEPS Action 10: Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions."

[2] O.E.C.D. (2010), "OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations."

date when parties enter into a commodity transaction.

- *Potential Additional Guidance* – When dealing with the transfer pricing of commodities among related parties, adjustments should be made based on physical deferences, processing costs, and other features of the transaction. The Discussion Draft invites responses to clarify the common adjustments or differentials on the quoted price and the sources of information used to conduct these adjustments or differentials. In addition, it specifies that the commodity transactions should be read with B.E.P.S. Actions 9, 10, and 13 to ensure that transfer pricing outcomes in commodity transactions are in line with value creation.

The complexity of commodity pricing has created the need for consistency within and outside the O.E.C.D. member countries. In particular, countries in the Latin American region have developed methods that create inconsistency. The potential for B.E.P.S. stemming from this inconsistency explains the O.E.C.D.'s motivation for proposing clear guidance on the application of transfer pricing rules to commodity transactions.