

JULY 2016

BEPS Amendments To OECD Transfer Pricing Guidelines

On 23.5.2016, the OECD Council approved amendments to its Transfer Pricing Guidelines (TPG) to incorporate Actions 8 to 10 and 13 of the BEPS Report. These actions cover “Aligning Transfer Pricing Outcomes With Value Creation” and “Transfer Pricing Documentation And Country By Country Reporting”.

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Actions 8 to 10

Actions 8 to 10 of the BEPS Report aim to ensure profit allocations are correctly aligned with the economic activity that produced the profits. The BEPS Report asserts that the arm’s length principle can be exploited to achieve profit allocations which are not aligned with the economic activity that produces profits. The emphasis on contractual allocation of functions, assets and risks has led to manipulation where outcomes do not necessarily match the value created by the economic activity carried out by members of a multinational group.

Associated enterprises are now required to control the risk and have the financial capacity to assume the risk for transfer pricing purposes. It is envisaged that transfer pricing analysis will now study the following:

- contribution (or value creation) of each related party in a transaction
- actual activities performed
- control over strategic decisions
- management or allocation of financial resources
- assumption of risk related to development, enhancement, maintenance, protection and exploitation of intangible property

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Reforms Summary

Transfer pricing reforms under the BEPS Report focus on 4 key areas:

- **Action 8** Designed to address the issues relating to moving intangible property among group members

- **Action 9** Addresses the adoption of rules and measures to ensure that inappropriate returns do not accrue to an entity solely because it has contractually assumed risks or provided capital when that entity does not play a significant role in value creation

- **Action 10** Recommends measures to clarify the circumstances in which a transaction can be recharacterised, clarify the application of transfer pricing methods and provide protection against common types of base eroding payments, such as management fees and head office expenses

- **Action 13** Revising current standards employed by taxing authorities regarding transfer pricing documentation requirements and country by country reporting in order to increase transparency (see our TP e-Alert Issue 2)

Changes To TPG

The specific changes introduced in the TPG are:

- **Chapter I, Section D**
Section D is deleted and replaced with a new chapter which focuses on determining the location of the value-adding activities with particular emphasis on risk and capital

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- **Chapter II**
New paragraphs dealing with the comparable uncontrolled price method are added in respect of the benchmarking of commodities transactions and use of trading exchanges
- **Chapter V**
Current chapter is deleted and the replacement provisions incorporate the new three-tiered approach (master file, local file and country-by-country reporting)
- **Chapter VI**
Current chapter and annex are replaced by a guidance clarifying the definition of intangibles and provides supplemental guidance for determining arm's length conditions in intangible transactions. The revision also introduces new guidance on risks and places significant emphasis on functions related to the development, enhancement, maintenance, protection and exploitation (DEMPE) of intangibles
- **Chapter VII**
Current chapter on intra-group services is deleted and the main focus of the new guidance is on an elective, simplified transfer pricing approach for low value-adding intra-group services
- **Chapter VIII**
Current chapter on cost contribution arrangements (CCA) is deleted and replaced with a new write-up seeking to ensure that the outcomes of CCA and the returns to participants are similar to any other arrangement with similar attributes. The new guide aims to prevent the use of CCA to circumvent the arm's length principle by clarifying the circumstances under which an enterprise will be considered to be participating in a CCA.

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Conclusion

OECD states that additional work is being undertaken to make conforming amendments to the remainder of the TPG, particularly Chapter IX (i.e. transfer pricing aspects of business restructuring). Clearly, BEPS have intensified the scrutiny of transfer pricing. Although Malaysia is not an OECD member, our transfer pricing principles are largely modelled after the OECD's TPG. In this regard, businesses should revisit their existing transfer pricing policies in light of these recent developments.

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