
**2015 IFA International Tax Conference
Thursday May 28-Friday May 29, 2015**

TELUS Convention Centre
Calgary, AB

Transfer Pricing Update

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Base Erosion and Profit Shifting Initiative

- The Organization of Economic Co-Operation and Development (“OECD”) initiative on Base Erosion and Profit Shifting (“BEPS”) will greatly impact how transfer pricing is done in Canada and around the world
- While BEPS is broken up into 15 Action Plans, 4 directly relevant to transfer pricing include 8 through 10 and 13

OECD Updates-Action Plan 8

- Actions 8, 9 & 10 – Assure transfer pricing outcomes are in line with value creation
- BEPS Action Plan Goals
 - Action 8 – Intangibles
 - “Develop rules to prevent BEPS by moving intangibles among group members”
 - Action 9 – Risks and capital
 - “Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members”
 - Action 10 – Other high-risk transactions
 - “Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties”

OECD Updates-Action Plan 8 (Con't)

■ Action 8 – Status

- Original OECD Discussion Draft - June 6, 2012
- Amended (second) draft published on July 30, 2013
- Most recent amended draft published in September 2014
- Discussion draft is work in progress as more revisions are expected
- Discussion draft contains several examples to illustrate guidance on transactions involving IP migration

OECD Updates-Action 8 (Con't)

- The OECD, however, deferred some of the most important decisions.
- OECD plans to finalize intangibles guidance in 2015 in conjunction with work on risks, recharacterization and hard to value intangibles

OECD Updates-Action 8 (Con't)

■ Action 8 – Impact

- Transfers of IP legal ownership without substantive functions being performed in offshore jurisdiction will impact the tax effectiveness of some IP migration
- IP profits to be more appropriately allocated in accordance with location of IP value creation
- For transfer pricing purposes, legal ownership of intangibles does not by itself confer any right to retain any return from the exploitation of the intangible.

Example 1: German Example

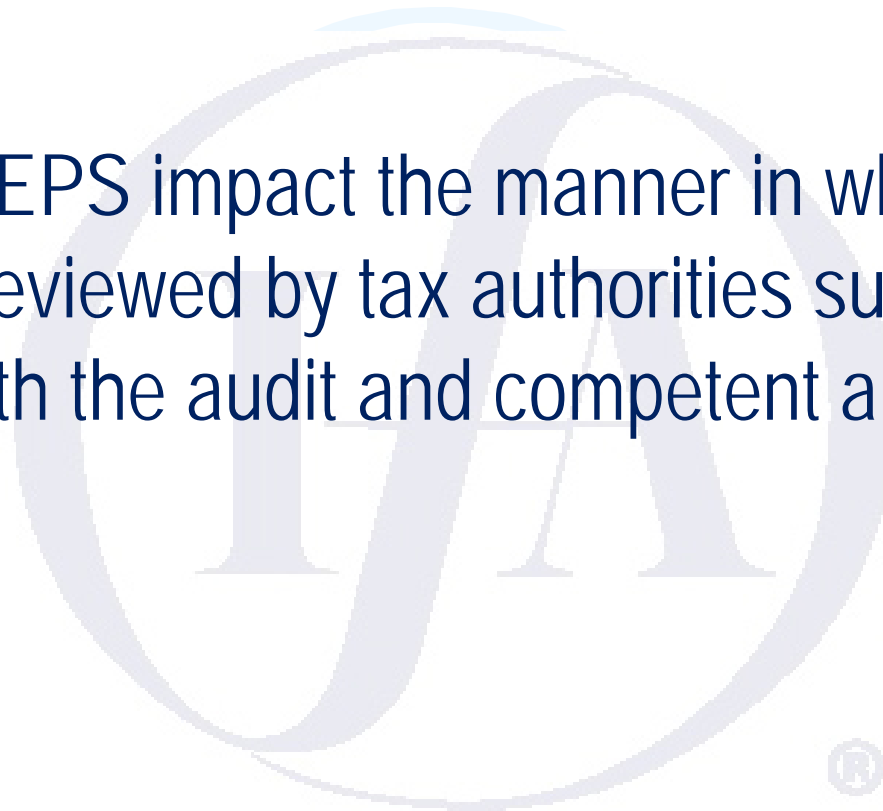


Example 2: Recharge/sell IP outside




Impact on Canada

- How will BEPS impact the manner in which transfer pricing is reviewed by tax authorities such as the CRA at both the audit and competent authority levels?



At the Audit Level

- Are the new BEPS guidelines clarifying in nature?
 - Audit has always put a heavy emphasis on:
 - People functions
 - Value creation
- Major implication of this position is that guidance is not a “new thing” that would only result in adjustments on a go forward basis, but is such that adjustments can be made to past years 

Implication of Action Plan 8

■ Important Question for Taxpayers and Service Providers

- What do we do if existing structures are in conflict with new guidance?
- Taxpayer's assessment includes:
 - risk of penalties if audited
 - self-initiated adjustments process

Implication of Action Plan 8 (Con't)

Important Question for Taxpayers and Service Providers

- Implications of “changing existing structure” to comply with BEPS
 - risk of triggering an audit if taxpayer corrects reporting on a go forward basis only
 - admitting that prior reporting was incorrect

At the Competent Authority Level

- For many years competent authority has been used effectively to relieve double taxation
- Given transfer pricing is not an exact science, a collegial approach has always been taken by competent authorities to resolve some very contentious transfer pricing disputes
- How will BEPS impact how competent authorities resolve files?

Dispute Resolution Avenues

- Appeals
- Competent Authority
 - Mutual Agreement Procedure
 - Advance Pricing Agreements
 - Arbitration
- Tax Court



Factors in Reaching a Negotiated Settlement

- Quality of documentation
- Availability of economic data
- Transfer pricing is not an exact science
- Materiality of adjustments
- Similar facts and circumstances in other cases
- Policy decisions

BEPS and its Impact on Competent Authority

- How Does BEPS effect the MAP Process?
 - Quality or volume of data may improve
 - If guidance is deemed to be clarifying in nature, results may be less subjective
 - Size of adjustments coming may become more material especially if sizable retroactive adjustments are raised and brought to competent authority
 - Introduction of BEPS will introduce a new learning curve

BEPS and its Impact on Competent Authority (Con't)

- Will some cases go to CRA Appeals/Court rather than MAP
- Will this hinder potential MAP settlement where some treaty partners view OECD guidelines as not clarifying in nature?

MAP results

- Highlights from the CASD 2013-2014 MAP Report:
 - 105 negotiated cases completed
 - Canadian initiated cases represented 88% of negotiated cases
 - The Transactional Net Margin Method (TNMM) was used in 36% of negotiated cases where a TP methodology was used
 - How will BEPS change the outcome of files?

OECD Updates-Action Plan 13

- Action 13 – Re-examine transfer pricing documentation
- BEPS Action Plan Goals
 - Objective is to make compliance simpler and more straightforward, while providing tax authorities with more useful information for TP audits
 - Country by country (“CbC”) reporting
- Status
 - On February 6, 2015 published guidance on Action 13.

OECD Updates-Action Plan 13 (Con't)

■ Overview:

- Implementation guidance on February 2015 specifically addresses the following areas
 1. Timing: OECD recommends that the first CbC report be filed for the fiscal years beginning on or after January 1, 2015

OECD Updates-Action Plan 13 (Con't)

2. Conditions for obtaining and using country by country report by tax administrations

- Confidentiality—Calls for countries to have safeguards on data in place
- Consistency- OECD guidance encourages countries to adopt the template
- Appropriate use – OECD suggests that use of CbC report to make formulaic adjustments should result in competent authorities promptly conceding the adjustment in proceedings

OECD Updates-Action Plan 13 (Con't)

3. Which companies will be required to file?

- MNC with a consolidated group revenue in the preceding fiscal year of 750 million Euros or more
- Legislation change may be required to implement CbC reporting

OECD Updates-Action Plan 13 (Con't)

- 4. Framework for government to government exchange of information
 - Parent company who meets threshold is required to file CbC report.
 - Would exchange this information on an automatic basis with countries in which conglomerate operates
 - If jurisdiction fails to provide information to other jurisdictions, there will be a secondary mechanism where the MNE would file the CbC report locally

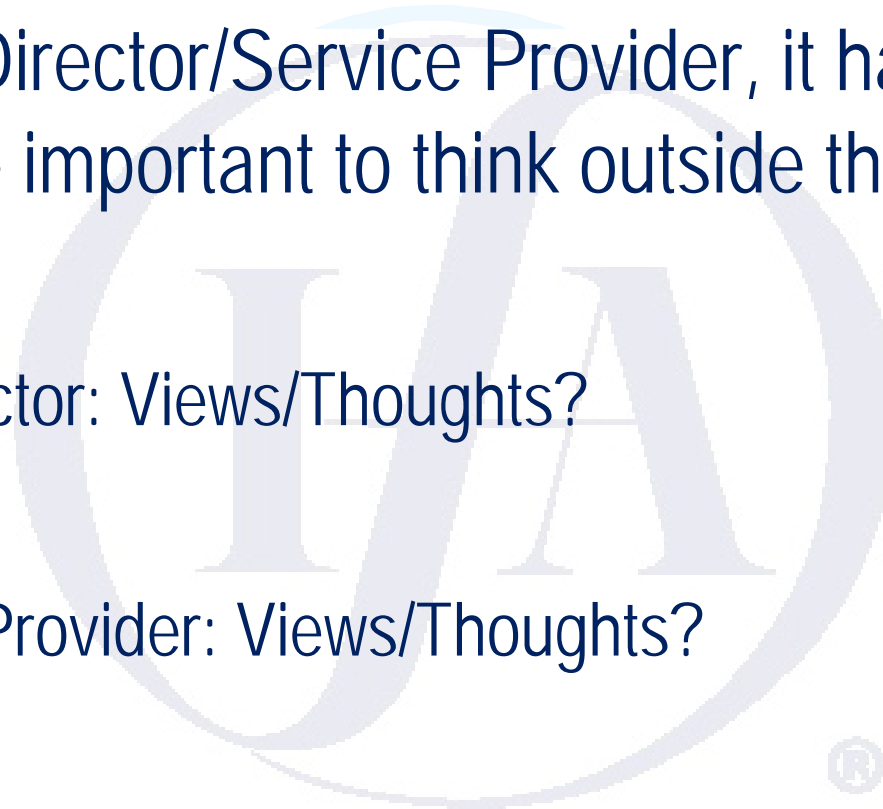
Implication of Action Plan 13

General Comments and Implications

- Highly contentious
- MNEs are concerned that certain financial information is not readily available
- Significant costs of compliance
- Concerns about tax administrations not needing the information or understanding it

Thinking Outside the Box

- As a Tax Director/Service Provider, it has never been more important to think outside the box
 - Tax Director: Views/Thoughts?
 - Service Provider: Views/Thoughts?





Thank you

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