PART ONE

Basic Transfer Pricing Standards

CHAPTER ONE

Introduction

THE ORGANISATION OF ECONOMIC *Co-Operation and Development (OECD) Transfer Pricing Guidelines* are becoming the international pricing standard. This pricing standard applies to multinational enterprises that have business relationships with their related enterprises or have business activities that have associated enterprises in differing tax jurisdictions. This pricing standard applies to the tax administrations that monitor these multinational enterprises. The OECD developed these *Transfer Pricing Guidelines* in July 2010 to impact multinational enterprises and tax administrations in equal fashion.

The OECD promulgated its *Transfer Pricing and Multinational Enterprises* in 1979. The OECD's Committee on Fiscal Affairs then issued the initial *Transfer Pricing Guidelines* on June 27, 1995, and the OECD Council approved publication of the *Guidelines* on July 13, 1995. The initial *Guidelines* included five chapters: the arm's length principle, transfer pricing methods, comparability analysis, administrative approaches to avoiding and resolving transfer pricing disputes, and documentation.

The Committee on Fiscal Affairs adopted the transfer pricing report as to property and services on January 23, 1996 (DAFFE/CFA[96]2). The OECD Council on April 11, 1996, incorporated Chapter VI, pertaining to intangibles, and Chapter VII, pertaining to services (C[96]46).

The Committee on Fiscal Affairs adopted the transfer pricing report as to cost contribution arrangements on June 25, 1997 (DAFFE/CFA[97] 27). The OECD Council on July 24, 1997, incorporated Chapter VIII (C[97]144).

The OECD has 34 members. All of these members apply many facets of the 2010 *Guidelines*. In addition to the 34 members, the OECD has 9 near members that follow the OECD precepts. Then, in addition to these 34 members and 9 near members, at least 7 countries voluntarily follow the OECD precepts. It is fair to state that these 50 or so countries that follow the *2010 OECD Transfer Pricing Guidelines* are participants in a voluntary but pervasive international tax system that includes virtually all nations that participate in international trade.

Despite the importance of the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, these *Guidelines* are an invention, taking 30 or so years to reach maturity. Some key dates to bear in mind are

- The discussion on transfer pricing began in 1979 with the OECD report *Transfer Pricing and Multinational Enterprises.*
- The OECD published the original *Guidelines* in 1995—but the *Guidelines* excluded intangible property, services, cost contribution arrangements, monitoring procedures, advance pricing agreements, and business restructurings.
- The OECD included guidance for intangible property and services in 1996.
- The OECD included guidance for cost contribution arrangements in 1997.
- The OECD included guidance for monitoring procedures in 1997.
- The OECD included guidance for advance pricing agreement procedures in 1999.
- The OECD included guidance for business restructuring in 2010.

The OECD has spent considerable effort in developing transfer pricing methodologies beyond the traditional comparable uncontrolled price method, the resale method, or the cost-plus method. These newer methods are the transactional net margin method and, most recently, the transactional profit split method.

Despite these great strides that the OECD has already undertaken to develop the transfer pricing system, it our view that the *Guidelines* themselves have three major defects:

1. Control
2. Tax havens
3. Complexities

CONTROL

The 2010 *Guidelines* are 371 pages in length. Absent from these *Guidelines* are control mechanisms—the manner in which one party is assumed to control another party. The *Guidelines* are quick to ascertain the consequences that are to take place if a controlled relationship exists, but the *Guidelines* are short on establishing the control parameters themselves and are *very* short on addressing one crucial facet: the presence or absence of "control."

- Countries might seek to ascertain the presence of control empirically, based on a data analysis, contractual provisions, or both.
- Alternatively, a government might issue its own transfer pricing control standards, based on common ownership, ownership over the second company, family ownership, or other criteria.

Regrettably, the OECD has chosen not to pursue this path of defining control, thus allowing countries to have differing definitions of control. Not having a universal definition of control, the taxpayer is at the mercy of each country regarding control issues.

TAX HAVENS

It is our view that the OECD has failed to pursue an examination of tax haven structures in the transfer pricing context. Outsourcing and reinvoicing are part and parcel of schemes that culprits undertake to shift income to tax havens, while hiding affiliated ownership in non–tax haven countries. As we shall see, the tax administrations are, even now, unprepared to challenge these tax-evading devices.

COMPLEXITIES

The OECD has undertaken some steps to eliminate transfer pricing complexities. Nevertheless, taxpayers need more guidance in complex areas. As of now, the OECD has been opposed to permitting taxpayers to apply safe harbors. Clearly, there is much to be done.