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List of abbreviations

ALP Arm’s length Principle

BEPS Base Erosion Profit Shifting

CIT Corporate Income Tax

CCCTB Common Consolidates Corporate Tax Base

CP Cost Plus

CUP Comparable Uncontrolled Price

FDI Foreign Direct Investment

IMF International Monetary Fund

MLI Multilateral Instrument

MNE Multinational Enterprises

OECD Organization for Economic Co-operation and Development

RP Resale Price

TNMM Transactional Net Margin Method

TP Transfer Pricing

TPM Transactional Profit Method

UK United Kingdom

WB World Bank

1. Introduction

This thesis aims to explain the impact of the Base Erosion Profit Shifting action developed by the OECD in related party transactions.

First, it is important to understand the context in which these operations were created and the reasons that are behind this quite recent transfer pricing regulation.

The first document was published in 1995, the Transfer Pricing Guidelines for Multinational Enterprises (MNE) and Tax Administrators were initially approved in that year by the OECD Council and by the Committee on Fiscal Affairs[1].

This initial version of 1995 has been complemented in many aspects during the following years from 1996 by the Report on Intangible property and services added to its Chapters VI and VII until 2017 with a review of the Transfer pricing impact on business restructurings.

They were already taking into consideration the intangible property in intra business operations, which would be further developed in the following years by the next Guidelines in 2009, 2010 and in the most recent one in 2017. It also included indications in cross-border services and advantage pricing arrangements.

In the Guidelines of 2009, the main progress was made on dispute resolution developments. While in 2010, the main focus was on transfer pricing methods and how to choose the most appropriated one depending in the circumstances of each operation and the relevance of the transfer pricing regulation in the business restructurings[2].

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[1] OECD (2017), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*, OECD Publishing, Paris. *http://dx.doi.org/10.1787/tpg-2017-en*

[2] 'OECD Ilibrary | OECD Transfer Pricing Guidelines For Multinational Enterprises And Tax Administrations 2009' (*Oecd-ilibrary.org*, 2019) <https://www.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2009_tpg-2009-en>

This most recent Guidelines will also be subject of future reviews and improvements.

2. Role of MNE in world trade

Due to the strong development of the new technologies and communications, Multinational enterprises have become crucial in the world trade after the drafting of the first Guidelines in 1995. These developments have lead to a higher integration of the world's numerous economies, which makes the overall tax regulation more complex than before because of the continuous interactions between the Multinational enterprises, triggering the need to the several tax administrators of working together in a coherent manner in order to avoid possible frauds by the Multinational entities.

One of the many issues that the OECD BEPS Action Plan tries to tackle is to determine the location of the income of a company or a permanent establishment and when it can be lawfully taxable or not, and in which jurisdiction it should be taxed.

In this fiscal context we have two main actors: on one side, the tax administrators, that need to coordinate their actions towards the BEPS and avoid any fiscal fraud; and on the other side, the Multinational enterprises, that have been drafting those business structures.

Tax administrators have to take action in two levels: the policy level and the practical one. At a policy level, countries must count on the right to tax the income that has been created lawfully inside their boundaries, preventing that the same income is taxed in more than one jurisdiction, avoiding the known phenomena of 'Double taxation', as well as the 'Double non-taxation', which is one of the main OECD concerns. This issue threatens the overall economy by impeding a regular movement of capital, goods and services. From a practical point of view, it is not easy for the States to calculate the taxable income because of the difficulty of obtaining the necessary data from outside their jurisdiction.

From the perspective of a Multinational enterprise, one of the biggest challenges is to comply with all the laws and administrative requirements of each country that are usually non-identical, inducing them to face higher costs of compliance for each jurisdiction they want to be present in.

Multinational enterprises are the main characters in the economic globalization process. This process has been accelerated in the last fifteen years due to three main factors, international trade, foreign direct investment (FDI) and international transfer of knowledge and technology. These channels are mainly used by them, inside their respective groups. In fact, eighty present of the payments for royalties and license fees are realized among parent companies and their affiliated abroad[3].

The economic globalization occurs in a context of imperfect competition because of the different legal frameworks of the countries.

Until the mid-nineteen eighties foreign trade and exports used to grow higher than foreign direct investment, but after the mid eighties, this pattern changed, and foreign direct investment started to grow in a faster path until it exceeded both factors. World real industrial production grew up to 60% in the last twenty-five years and consequently, the annual growth rate.

During the eighties the foreign direct investment was mostly generated and invested in developed countries, specially the U.S., Japan, UK, Germany and France. This situation has changed in the last decade and the FDI is currently aimed at developing countries. The reasons behind this change are largely fiscal, and they will be analyzed in this thesis[4].

Also, the payments of royalties and license fees have risen these last decades due to the transfer of knowledge and technology. In 1990, the payments of royalties and license fees were mostly among developed countries. In fact, the U.S. alone received more than a fifty percent of all the royalties and license fees, followed by Japan, UK, Germany and France. Around 80% of technology flows are intra-firm flows; this is an evidence that shows the important role of multinational enterprises in the world trade. The spread of the transfer of knowledge and technology abroad also trigger the internationalization of the knowledge protection, since the patents of the companies needed protection when the

[3] UNCTAD, 'World Investment Report 1997' (United Nations 1997) <https://unctad.org/en/Docs/wir1997_en.pdf>

[4] UNCTAD, 'World Investment Report 2000' (United Nations 2000) <https://unctad.org/en/Docs/wir2000_en.pdf>

company transferred that knowledge and technology to another new country. Despite of this, most developed countries kept maintaining the R&D inside them (Pavitt and Patel 1999), causing a rise in the flows of transfers of knowledge and technology while the production of it was frequently kept in the home States of the MNE, where their headquarters were, supplied by the parent company and used by foreign affiliates, increasing consequently, the trade in headquarter services, and a rise in trade in services

It is possible to conclude that MNE are the main actors in the internationalization of economic activity, and the regulation of the intra-group transfer is the central theme of this thesis[5].

3. Context and history of the BEPS project

Continuing with the previously expressed, the process of integration of national economies and their respective markets has increased enormously these days. Before the action carried out by the OECD, the tax regulations differed greatly among the different countries, thus facilitating the Base Erosion and Profit Shifting (BEPS) opportunities for the MNEs. In view of this situation, tax administrators were faced with the need to agree on the development of their policies so that the profits were correctly taxed in the place where they were generated.

In September 2013, the leaders of the G20 together with the OECD and some developing countries and organizations such as the International Monetary Fund, the World Bank or the United Nations, created the Action Plan on BEPS, composed of 13 Reports in which international standards are included and concrete measures to fight against the Base Erosion Profit Shifting. It was applied a couple of years later in 2015.

[5] Kleinert, J. (2001). *The Role of Multinational Enterprises in Globalization An Empirical Overview*. Kiel (Germany): Kiel Institute of World Economics, pp.1 - 30.

It is difficult to measure the exact effect of the BEPS measures created in 2013, however it is estimated that between 4% and 10% of the global corporate income tax (CIT) revenue is lost through those actions by multinational companies , which could amount to a total amount of between 100 to 240 billion dollars per year[6].

These losses derive from multiple causes, the main ones being the aggressive tax planning used by some multinationals, the lack of coordination together with the lack of transparency among tax administrators and the poor coherence of domestic tax rules. All this added to a limited power of enforcement of these anti-tax fraud measures. The OECD states that affiliates of multinationals located in low tax countries register a ratio of almost double the benefit in relation to their assets. (OECD 2018). This data is a clear indication of how the BEPS affect the group's business structure.

Nowadays with the Globalization process, it is fundamental that there is an international coordination of tax legislations that contributes a certain level of coherence with the current paradigm. This would create a climate of greater security for companies and, therefore, a more certain context for transfers and investments between companies located in different countries. In case of not taking these measures, the CIT would be the cause of the resources mobilization and business restructuring, which could be very harmful for the world's economy and specially for developed countries. The BEPS Action Plan is aimed at providing tax administrators with the necessary instruments to ensure effective fiscal policies at both, national and international level.

The creation and implementation of the BEPS project has been an accelerated process to prevent the countries from developing unilateral measures that would subsequently damage the international tax framework. Base Erosion and Profit Shifting could lead to double taxation, while acting against BEPS should avoid this undesirable result. The OECD issued a publication stating that it is the interaction between the different tax administrators and domestic rules that lead to BEPS, since no single tax rule enables it. The main issue that the OECD is trying to tackle with this is the lack of coordination between countries in terms of their national laws and rules. The BEPS Action project is

[6] David Bradbury, Tibor Hanappi and Anne Moore, 'TRANSNATIONAL CORPORATIONS' (OECD 2018) <https://unctad.org/en/PublicationChapters/diae2018d4a6.pdf> accessed 14 September 2019.

not a case by case solution but it is aimed at being a 'comprehensive package measures' (OECD 2018) to be implemented in a way to all countries and attacks the core of the possibilities of committing any action BEPS by multinationals.

The application of these measures should ensure that the benefits of the economic activities of a company and its affiliates are properly taxed in the territory in which it is general, that is, to maintain the relationship between the place of development of the economic activities and the creation of value, minimizing in turn the possibility of double taxation.

3.1. BEPS Plan and its impact in controlled transactions

The domestic tax Base Erosion and Profit Shifting is possible for Multinational enterprises that are willing to take advantage in the gaps and mismatches among the multiple country's tax jurisdictions they are present in. Through these practices, Multinationals manage to pay a lower tax on their profits, harming those countries that should have a greater collection due to the profits generated within their borders. According to the OECD, the countries that suffer the most the effect of the BEPS are the developing counties because they depend more in the corporate income tax[7]. Since Multinational enterprises operate at an international level, all governments, specially the OECD Member States, must cooperate to tackle this issue.

Nowadays more than a hundred and thirty countries collaborate to minimize these practices implementing the OECD-proposed actions. The total cost of the BEPS actions carried out by the Multinationals reach the $240 billion of loses annually, which is equivalent to 4-10% of the global corporate income tax revenue[8].

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7 Oecd.org. (2018). *OECD/G20 Inclusive Framework on BEPS*. [online] Available at: http://www.oecd.org/tax/beps/flyer-inclusive-framework-on-beps.pdf

8 Bradbury, D., Hanappi, T. and Moore, A. (2018). *Estimating the scal effects of base erosion and pro t shifting: data availability and analytical issues*. [online] Unctad.org. Available at: https://unctad.org/en/PublicationChapters/diae2018d4a6.pdf

To sum up, the BEPS Plan basically fights against the Multinational enterprises groups that artificially shift profits from one jurisdiction to another to reduce their global tax expenses. Most of these business strategies are actually legal but the fact of avoiding taxes would not be fair in terms of competition for other businesses because it gives an unfair competitive advantage to these Multinationals than can afford to build these business structures over national businesses.

The OECD/G20 BEPS Project aims to tackle these practices. It encompasses fifteen actions against tax avoidance in order to help improving the coordination among tax jurisdictions at an international level to have a more transparent tax environment. In 2016 the OECD/G20 Inclusive Framework on BEPS was proposed to include interested counties to form part in the evolution of the BEPS actions. Subsequently, a year after, eighty-five jurisdictions signed the so called Multilateral Instrument (MLI). This MLI has legal value as a Tax Treaty and consequently it does not require any implementation so the signatory countries won't need to make bilaterally individual Tax Treaties. Due to this Multilateral instrument, around a thousand five hundred Tax Treaties will be modified.

3.2. Definition of controlled transaction

A controlled transaction is a business carried out between associated enterprises. This definition may lead to the question of what does it mean to be an associated party and when two companies are considered to be associated in order to determine if the transactions that they may make between each other are classified as controlled or uncontrolled transactions.

There is no unified company law in the European Union countries, therefore the criteria used to determine whether a company is associated or not may vary from country to country. Most of the countries look at the following four items: the percentage of voting rights, the voting power, other relevant rights in regards to the administration or management of the company and the title of control over the assets[9].

4. Introduction to the OECD Transfer Pricing Guidelines

4.1. Definition and structure of transfer pricing

After explaining the context of transfer pricing and putting it into perspective, it is mandatory to define the exact meaning of this word.

Transfer pricing are the terms and conditions of transfers made within business belonging to the same group. Transfer pricing has its main focus on the prices established to carry out such transactions between associated enterprises which are usually, not necessarily, located in different jurisdictions. The great concern of tax authorities is that Multinationals manipulate these prices when carrying out cross-border transactions in order to reduce the taxable benefits in one jurisdiction and transmit them to another where a lower tax is demanded[10].

Given this situation, Transfer Pricing rules have seen a strong development in the recent years, acquiring a deserved role among policy makers. At a European level, it is possible to affirm that this phenomenon is one of the big problems facing the internal market, damaging both the national tax administrators and the businesses, due to the interpretative

[9] Rossmartin.co.uk. (2019). *What is an associated company? - RossMartin.co.uk*. [online] Available at: https://www.rossmartin.co.uk/companies/running-the-business/181-what-is-an-associated-company

[10] Taxation and Customs Union - European Commission. (2019). *Transfer pricing in the EU context - Taxation and Customs Union - European Commission*. [online] Available at: https://ec.europa.eu/taxation_customs/business/company-tax/transfer-pricing-eu-context_en

differences of the OECD Transfer Pricing Guidelines for MNEs and Tax Administrators between the different countries[11]

5. The arm's length principle and principle of free competence

5.1. Context and definition of the Arm's length principle

The transfer pricing rules first appeared in the year 1915 in the United Kingdom with the creation of the Finance Act, which gave the UK Commissioners the power to analyze the income tax of non-residents when, in the course of transactions between them and residents between which there was a 'close connection' and 'substantial control', no benefit was declared or the declared benefit would be lower than normal. In 1917, the U.S. created a similar law, the 'War Revenue Act', which granted power to the U.S. Tax administration to consolidate the accounts of any related trade or businesses whenever it is considered necessary for the estimation of the taxable income or of the invested capital. In both early regulations the terms 'ordinary', 'equitable' and 'accurate' already appeared, to designate the income that should be declared[12].

A decade later, the League of Nations created the first Draft Model Convention for the Prevention of Double Taxation and Evasion, where the concept of 'permanent establishment' is used to determine the taxable income generated in a specific jurisdiction (Lang, Storck and Petruzzi, 2016). In accordance with article 5 of this Convention: "Income from any industrial, commercial or agricultural undertaking and from any other

[11] 'Taxation Trends In The European Union' (Publications Office of the European Union, 2019)

[12] Lang, M., Storck, A. and Petruzzi, R. (2016). *Transfer Pricing in a Post-BEPS World*. 1st ed. Alphen aan den Rijn: Wolters Kluwer, pp.3 - 9.

trades or professions shall be taxable in the State in which the persons controlling the undertaking or engaged in the trade or profession possess permanent establishments''[13].

In spite of these first efforts, the most complex was to determine the exact amount of profits that could be taxed in those territories. In this decade two systems were established for calculation: on the one hand the so-called 'separate accounting approach', based on the evaluation of the quotas separately from all the permanent establishment; and on the other hand, the taxable profit determined according to the agreements between both States. The former was soon discarded because the time it took to compile all the accounts was expensive and impractical.

The main issue remained then, unresolved, how to determine the taxable business income. In 1921, a notorious American tax economist, Thomas S. Adams, conducted a study of the methods of determining the tax base in different countries, reaching the conclusion that it was essential to make a comparison between the same operations in similar local businesses (Lang, Storck and Petruzzi, 2016). From the point of view of the American economist, business should be taxed to cover the costs of its creation and maintenance in the market; as well as to distribute the benefits in it. Mr. Adams also stated that the percentage of each industry's tax should not be the same, since it should detract from the relationship between net income and gross business. However, the tax would be applied equally to profitable companies as to those that were not, since both had taken advantage of the structures of the markets[14].

Subsequently, Mitchell B. Carroll, an American attorney, developed a survey about the 'Methods of Allocating Taxable Income', known as the Carroll Report, whose purpose was the fair and fair allocation of business income, taking into account both the legitimate rights of the tax administrators as the needs of global commerce and industry (Lang, Storck and Petruzzi, 2016). The Report comments that the profits of a business could be

[13] Alexander Bosman, *Other Income Under Tax Treaties* (1st edn, Kluwer Law International 2015).

[14] Thorndike, J. (2009). *Tax History Project -- Early Proposals for an American VAT*. [online] Taxhistory.org. Available at: http://www.taxhistory.org/thp/readings.nsf/ArtWeb/6F4B8EADA426FDCE852575F600464B81?OpenDocument

transferred from a national entity to a foreign subsidiary "though artificial invoice prices or otherwise "[15].

The BEPS Action mentions some of the ideas that appear in the Report as evidence of the alteration of prices in intra-firm transfers, as well as the influence of tax rules on business restructurings. It also proposes several methods and principles for the allocation of income, among which the most relevant is reflected in the Report stating that the branch establishments should be treated "as independent entities, in order that the income allocated to a branch may be equivalent to that which would have been derived by an independent enterprise ".

A few years later, in 1933, the League of Nations established the 'arm's length principle' as the most appropriate method for the allocation of taxable business income which was in turn preferred by the OECD in its OECD Model Tax Convention on Income and on Capital and in the UN Model Double Taxation Convention between Developed and Developing Countries (Lang, Storck and Petruzzi, 2016). This principle is based on the idea that the corporate income tax should not affect Foreign Direct Investment.

Nowadays sixty percent of the world trade takes place in MNE, this entities used transfer pricing in every operation inside their groups, so transfer pricing influences directly the allocation of profits inside the group, which affects at the same time, the taxable income in a jurisdiction[16].

For a better understanding of this concept it is good to make an example. Let’s say a Swedish mobile phone group buys a micro chip from India, and the price for this buy is 10 euros. Indian authorities will tax the benefit that the Indian company obtains in India, and those 10 euros are earnings for this entity so it is part of it’s benefits, while in Sweden, those 10 euros are part of the costs. But if the Swedish company pays 5 euros for the

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[15] Andreas, B. (2011). *Arm's lenght Transaction Structures Recognizing and Structuring controlled transactions in transfer pricing*. Amsterdam: IBFD Doctoral Series, p.94.

[16] John Neighbour, 'Transfer Pricing: Keeping It At Arm’S Length - OECD Observer' (*Oecdobserver.org*, 2008) <http://oecdobserver.org/news/archivestory.php/aid/670/Transfer_pricing:_Keeping_it_at_arms_length.html>

microchips, then there will be more benefits in Sweden, since the microchips were bought at a lower cost, than in India, because they earn less money than before (Neighbour, J., 2008).

With this simple example it is possible to see how transfer pricing works in a basic basis.

We can make it slightly more complex with this other example. If a manufacturer of washing machines from France produces them for 800 euros and sells them to a distributor in the Netherlands at 900 euros, earning 100 euro profit; and afterwards the Dutch company sells them at 1100 euro, with an additional cost of 100 euros for the distribution, so registering a profit of 100 euros. The French tax authorities will tax those 100 euros and the Dutch will also tax 100 euros. But if the French company sells the machines with a transfer pricing of 1000 euros, then the profit will end up being 200 euros in France and 0 euros in the Netherlands. Here is where the OECD arm's length principle takes place (Neighbour. J., 2008).

The arm's length principle establishes that the transfer pricing should be the same in two companies of the same group, than between two independent companies. Despite its ordinary denomination, this principle is located in the article 9 of the OECD Model Tax Convention and it is also the main pillar of the BEPS Action towards transfer pricing (Neighbour, J., 2008).

In this previous case, the MNE and the governments could collaborate for solving this issue. However, this would be the best case scenario in which governments and MNE work together in good faith. This is not always the case, and transfer pricing is usually used for shifting profits among entities of the same group from one jurisdiction to another lower tax jurisdiction. These profit distortions lead to a tax distortion and this effect is undesirable for any country. Specially for developing countries where MNE look for ways of repatriate the profits in a tax free way (Neighbour, J., 2008).

For this reason, the OECD Guidelines have a double impact in MNE, to avoid Double Taxation and on the tax administrators, to obtain their fair share of taxable basis from the entities located therein (Neighbour, J., 2008).

Because of this, the arm's length principle has been developed by the OECD to avoid any possible trap, since it is based on real markets, so the taxes of each jurisdiction can be justified in a fair base. It can also deal with many challenges such as global commerce and electronic commerce[17].

Currently, the BEPS Project has identified the three main causes of misapplication of arm's length principle by multinational enterprises in the course of their business activities. These cause are:

- The development and transfer of intangibles for a lower value to the real and the strategic allocation of the profits obtained from it to a part of the companies in the group.

- The excess of capital located in low-taxed undertakings in relation to the rest, capital that usually comes from entities located in high-tax jurisdictions.

- The allocation of risk given to business in low-tax jurisdictions[18].

5.2. Application of the ALP

Prior to the presentation of the methods, it is important to remark that all OECD Member States base their laws in the OECD Guidelines, but these Guidelines lack of legal status; thus the OECD Member States can have different laws in regards to these Transfer Pricing methods with diverse points of view[19].

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[17] Neighbour, J. (2008). *Transfer pricing: Keeping it at arm's length*.http://oecdobserver.org/news/archivestory.php/aid/670/Transfer_pricing:_Keeping_it_at_arms_length.htmls

[18] Pankiv, M. (2017). *Contemporary Application of the Arm's Length Principle in Transfer Pricing*. 6th ed. Amsterdam: IBFD, pp.1 - 4.

[19] OECD (2010), *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010*, OECD Publishing, Paris, https://doi.org/10.1787/tpg-2010-en

Despite this, these Transfer Pricing methods are accepted by most of the tax authorities. The OECD proposes in its Guidelines for multinational enterprises and Tax Administrations of 2017 five Transfer Pricing methods to examine all types of controlled transactions and check whether they are in line with the arm's length principle.

There are two big categories in which the five Transfer Pricing methods can be classified: the traditional transaction methods on one hand, and the transactional profit methods on the other. To opt for the use of one category instead of the other it is necessary to take into consideration the characteristics of each method, its strengths and its weaknesses, as well as the information available and possibly gathered about the specific transaction, a functional analysis should be made, verifying the quality and quantity of information available and the detail and comparability of it between the controlled and uncontrolled transactions. The OECD has made a proposal of five methods because there is no general rule that can be applied to every situation, each case must be analyzed in order to apply the most appropriate method to evaluate the transaction.

The adoption of a methods depends on its features. The traditional transaction methods are good to examine the terms and conditions of the commercial and financial relations between associated enterprises. The comparison of a controlled transaction with an uncontrolled transaction can be made through direct measures, using for instance, the price f a transaction as a reference to compare; or though indirect measures, adopting gross margins of the transaction. Tax authorities are more bound to follow the traditional transaction methods because it makes it easier to trace and to determine where the price differences between the compare transactions have their origin.

On the other hand, transactional profit methods evaluate the profit levels, so as the net operating profit realized from transactions between associated enterprises and compares that profit to the one realized in independent ones that are involved in similar operations. This means that the transactional profit methods do not focus on evaluating the terms and conditions as the traditional transaction methods do. So this category basically looks at the split of profits that would have been realized if all these transactions were made by independent enterprises[20].

This more generic approach makes them less precise than the others, but also frequently used because of the lower requirements of information that in practice is quite difficult to obtain.

These two big classification of methods include some subcategories. The traditional transaction methods comprise the comparable uncontrolled price methods (also known as the CUP method), the Resale price method and the Cost Plus method. The transactional profit methods encompass the Transactional Net Margin Method (so called TNMM for its acronym) and the transactional profit split method. Taxpayers have to choose the most appropriate one among these five. Whenever the two categories of methods are equally reliable, the traditional transaction method must be applied. Also, when the CUP methods and any other method are equally valid, the CUP methods must be chosen.

It is also essential to notice that there are situations where the transactional profit methods represent a better option, for instance when the activities developed by the associated enterprises and the transactions among them have a high degree of integration. This category of methods is also more appropriate in cases when there is no much information available, since it is less precise than the traditional ones. The methods that are based on profits as the indicator are only valid if the type of transactions are comparable and always compatible with article 9 of the OECD Model Tax Convention[21].

The OECD empathized the fact that transactional profit methods cannot be used to over-tax or under-tax an enterprise that makes higher or lower profit in one jurisdiction due to commercial reasons.

[20] 'Transfer Pricing Guidelines For Multinational Enterprises And Tax Administrations' (OECD Publishing 2017) <https://read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en#page4>

[21] Article 9 of the model tax convention: OECD (2017), *Model Tax Convention on Income and on Capital: Condensed Version 2017*, OECD Publishing, Paris, https://doi.org/10.1787/mtc_cond-2017-en.

In the following pages the Transfer Pricing methods will be explained in detail- the main points such as the definition of each method, the cases in which it can be used and some examples of those cases. Further to that, it is important to mention that multinational enterprises are free to apply other methods apart from the five ones described in the OECD Guidelines to keep their transactions always in accordance with the arm's length principle, however such methods cannot be used whenever the OECD described ones are more appropriate and the multinational enterprise will always have to justify its decision with proper evidence and documentation of the reasons why the other method was chosen in spite of the OECD recognized methods. Last but not least a taxpayer is always obliged to have supporting documentation of the prices of its transactions and of the Transfer Pricing methods it has used. There is no general rule for applying a specific method so the taxpayer has to do his best to use the one with a higher degree of comparability[22].

The OECD advise against the use of more than one method because of the concern that this could cause to both, the taxpayers and the tax administrators. However, if could be a possibility to use more than one method when there is no method that can encompass all the real scenario of the transaction.

5.3. Transfer Pricing Methods

This part will introduce the first category of Transfer Pricing methods, the traditional transaction methods.

[22] 'Transfer Pricing Guidelines For Multinational Enterprises And Tax Administrations' (OECD Publishing 2017) <https://read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en#page4>

5.3.1. The Comparable Uncontrolled Price Method (CUP)

The comparable uncontrolled price method confronts the terms and conditions of a controlled transaction with the ones of an uncontrolled transaction focusing on the price established for the property of the services transferred.

For the use of the CUP method, one of this following two requirements must be met:

- The differences between the transactions and the enterprises are not too big that they affect materially the price of the transaction in the open market; or
- Some small adjustments can be made to make the material effects disappear.

This method is the most reliable one of all. Nevertheless, it is not easy to find the perfect circumstances to apply it. For this reason, the higher the need of adjustments, the lower the reliability of this method. Therefore, this method can only be used if there is a lot of data available and the differences are not big enough to make its application non-viable.

The CUP method is used often in transfer of commodities or royalties for the use of intellectual property, interests rates or raw materials such as metals, oil or sugar[23]. The term ''commodity'' englobes any physical product that can be transferred from one enterprise to another for a quoted price. The quoted price is a price used as a reference by independent parties that belong to the same industry to set a monetary value for the transfer of the commodity. This quoted price is the one that the commodity has in a certain period of time, either in the international or domestic commodity exchange market, but it can also be obtained with the indicators of reliable price-setting agencies, as long as said value is duly justified.

For the use of this method it is crucial to pay attention to all economically relevant features, such as the physical characteristics of the commodity, the contractual terms of the transactions, the periods of time when the price is set and the commodity is transferred, the transportation times and costs, the foreign currency terms, if applicable,

[23] 'OECD Transfer Pricing Methods' (PricewaterhouseCoopers LLP 2016) <https://www.icpak.com/wp-content/uploads/2016/07/OECD-Methods-ALICE-AND-TITUS.pdf>

or the volumes traded (whenever there is a volume discount). Taking a closer look at the terms of the transaction, if any difference is found, the taxpayer will then have to make reasonable adjustments.

The taxpayer must provide document and prove of the price-setting policy of the transaction (the pricing formulas used, the premium or discounts applied, the supply chain and the pricing date that is very relevant and it must be consistent with the developing of the business.

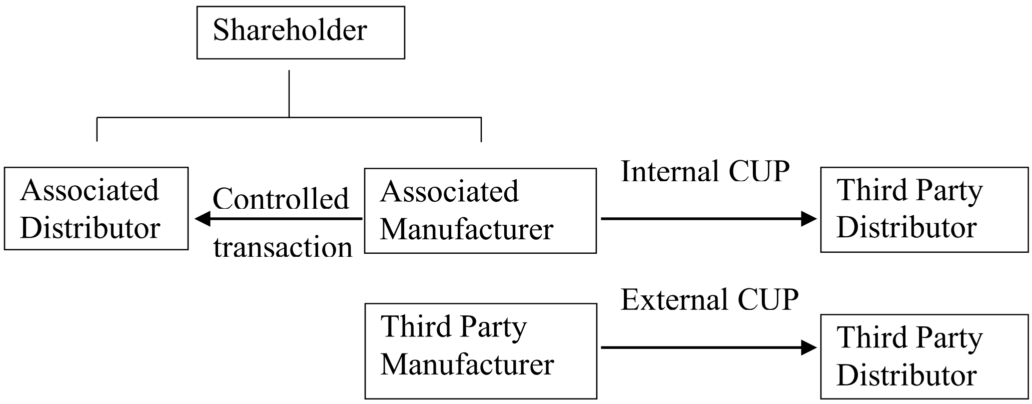
The CUP method is especially appropriate when the product of the associated and independent parties is the same. For a deeper understanding of how this method works is convenient to give an example. This method would be used if company A sells Spanish grapes to an associated enterprise that are the same type, quality and quantity of the grapes sold by the independent enterprise. If the grapes sold by the independent party were from Australia, it would be necessary to check if the differences of the grapes can cause any material effect on the price of the transaction. If this is the case, some adjustments should be made, but as it has been mention previously, the need of adjustments would reduce the reliability of this method, making a better option to choose another less precise one[24].

There are two ways to see the CUP method in practice:

- External CUP: when the taxpayer uses two independent enterprises for the comparison.
- Internal CUP: when the comparison is made between the taxpayer and an independent enterprise.

[24] 'Transfer Pricing Guidelines For Multinational Enterprises And Tax Administrations' (OECD Publishing 2017) <https://read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2017_tpg-2017-en#page4>

In the following figure it is possible to see clearly the differences between both:



5.3.2. The Resale Price Method

The start point o this method is the price of a product that an enterprise that has bought it from an associated party, now resale it to an independent enterprise. This base-price (the resale price) is reduced afterwards by a gross margin on it (the so called ‘’resale price margin’’). This margin refers to all the expenses that the associated party has incurred in order to resale the product to the independent enterprise. The price that is left after the reduce would be at arm’s length principle (OECD 2017). This method can be done internally, between the associated party and the independent party; and externally, between independent enterprises.

Typically used for tangible goods and then the reseller doesn’t add too much substantial value to the product when reselling it. This method could be affected also by the differences of efficiency or management of the enterprises that also influence the price margin. The Resale Price method can be used in cases when the reseller abstains from transforming the product by adding substantial value to it. In a situation where the product is processed or mixed with other goods in a way that It becomes a part of a semi finished good, then this method would be hard to apply. This method shouldn’t be used also in cases where the reseller works actively for the maintenance of intangible property related to the product (meaning trademarks for example), because the value of this work is not easy to determine and the reseller would also need to give proof of his actions. Taking all of this into account, it is possible to reach the conclusion that the best way to use this method is in a case where the product is sold in a short period of time after its purchase, the more time between the first purchase and the resale of the products, the more changes can happen in the market (change of rates, costs, etc). The role of the reseller is crucial and varies the price of the intangible if his activity's effect on the price is considerable, through activities such as marketing, advertising, R&D costs or when the reseller assumes greater risks for the product, the price can also rise (OECD 2017).

5.3.3. The Cost Plus Method (CPM)

The Cost Plus method defines the costs of the supplier in a controlled transaction for the transfer of a product to an associated party. This method consists in adding a mark-up to the cost that represents the value of the functions performed by the supplier. At the moment of application of this method, one must determine a difference between the selling price and the costs incurred for the products or services, this difference is the so-called mark-up, and refers to the profit that the supplier would have made if the transaction was between independent enterprises (OECD 2017).

This method could be used for routine low-risk transactions, such as the transfer of semi finished goods between associated parties, where both have a long-term agreement or where the controlled transaction is part of the business process.

The cost plus mark-up that is added to the transactions should be, if a possible comparison is made, equal to the cost plus mark-up of an uncontrolled transaction carried out by the same supplier (internal comparable) or the cost plus mark-up of the same transaction between independent enterprises.

This method is not frequently used due to the need of a high degree of comparison between the transactions and the characteristics of the companies to be compared (operating costs, size of the enterprises, type of product). The Cost Plus method is particularly difficult to apply in cases where the link between the price and the profit of the good or service is not clear. For example, when a valuable discovery is made and the cost of it was only a little research, the profit will be probably hard to evaluate.

Another conflicting aspect of the Cost Plus method is the accounting consistency and comparability. It can happen that the enterprises to be compared follow distinct accounting practices, if this is the case, some adjustments will need to be made in order to classify the costs of the transaction in the same manner.

It can happen that this method overlooks additional costs between the suppler and the purchaser, sometimes the purchaser (generally the parent company) incurs in costs that lower the costs of the supplier (often the subsidiary), this rises the issue of costs allocation that has an effect in the costs estimated through this method.

An example in which this method could be an option is a research activity carried out in one company while all the related risks are assumed by an associated party. In his case, the additional cost plus mark-up should represent the value of the innovation and the costs of the research and risks assumed should have to be compensated.

5.3.4. Transactional Profit Methods

The Transactional Profit Methods analyze the profits generated out of controlled transactions. The two methods explained in the OECD Guidelines are the Transactional Net Margin Method and the Profit Split method.

The Transactional Net Margin method analyses the net profit in relation to a certain base that could be the costs, sales or assets that the taxpayer makes in the course of the controlled transaction. The way it operates is that the net profit indicator used in this methods should be equal to the one in the uncontrolled transaction (internal comparable); if this comparison is not possible, an external comparison between two independent parties will be necessary (OECD 2017).

This Transfer Pricing method has a lower requirement of precision because it looks for transactions that are similar, they don't need to be the same. However, this method is not used when each of the parties involved in the transaction makes unique and valuable contributions.

On the one one side, an advantage of this method is less affected by transactional and functional differences than other ones. Also it erases the dissimilarities among accounting practices where costs can be classified differently.

Additionally, as a one-sided method, only one of the associated parties will be analyzed (also known as the ''tested'' party). Also, there is no necessity to check all the books of the parties and to allocate any of the costs (which happens in the Transactional Profit Split method). This is a very important advantage, specially when one of the parties is included in multiple activities.

Nevertheless, it is always mandatory to make a general comparison of all the parties involved to opt for the most appropriated Transfer Pricing method. Another weakness if that it might not be easy for the taxpayers to find specific information of the profits attributable to compare uncontrolled transactions, in addition to the complexity of determining the net profit indicator. Similarly, to the Resale Price and the Cost Plus methods, the Transactional Net Margin method is only applied to one of the associated parties (the so called ''tested'' party).

The OECD offers some explanations for the application of this Transactional Net Margin method. The first step to check the adequacy of this method is to see the availability of information. Prices may alter when the products present some differences, and gross margins also fluctuate due to the various functions performed, the net profit is not as much affected by such differences, but it can also vary through other factors that, on the other hand, have a smaller effect on price and gross margins. In addition, some facts such as the competitive position may affect the three of them (prices, gross margins and net profit) but it is harder to isolate this effect from the net profit (OECD 2017).

The characteristics of the company and the industry itself may provoke a more relevant effect in the net profit indicators. To mention some examples, the thread of potential competitors, competitive position, efficiency or group strategies, potential substitute products, costs structures, cost of capital structure (more financing or borrowing), and the time that the enterprise has been developing this activity in terms of experience. For instance, if a company sells iron tubes to an associated enterprise where there are few competitors, the product has a considerable degree of differentiation and the entry barriers are also high, an adjustment will need to be done. The profitability of two companies that belong to the same industry can vary a lot in relation to many factors, such as their market shares for instance. This method that compares the net profit has to take into account also the accounting treatment of some expenses that can affect the profit such as depreciation or reserves.

For selecting the most adequate net profit indicator, it is crucial to see the features of each indicator, their strengths and their weaknesses in order to choose the one that is more suitable. Also it is imperative to eliminate the costs and revenues that are not related to the controlled transaction and, when examining the uncontrolled transactions to compare, remove the controlled transactions that the independent party may make because they would distort the indicator. Also non-operating elements such as interest's income or taxes and extraordinary expenses should be eliminated from the analysis. Notwithstanding that these elements can also be useful it they provide information for the analysis (for instance of the tested party is assuming some risks) or for financial activities where the advances are the ordinary business or the taxpayer.

At the time of establishing the net profit, the denominator should represent accordingly the net profit of the controlled transaction and the allocation of risks. For example, when the controlled transaction is done by an enterprise with a capital-intensive activity, with a considerable investment risk, the return on investments or return on capital employed might be a good indicator. The relevant indicator used should represent the functions performed by the tested party in the controlled transaction.

5.3.5. The Net Profit Method

On the other side, the Net Profit method is useful in cases where transactions between associated parties are very interrelated. Therefore, it is quite hard to distinguish each transaction from another. This method propones to divide the total profits among the associated parties. This division of profits has to be the same that independent parties would have done.

This method starts with identifying the profits realized from the controlled transactions and splits them afterwards among the associated parties.

The main advantage of the Profit Split method is that it makes it easier to examine highly integrated transactions that would be more difficult to analyze though any of the one-sided methods. This two-sided method is usually applied in situations where more than one party makes valuable contributions to the controlled transaction, these contributions will be taken into account with this method to assign the profit that belongs to each of the associated parties.

For the division of profits, it is always advised to make a comparison of a similar uncontrolled transaction. Nonetheless this is not always feasible. If this is the case, the profits will be split considering the functions performed. Another downside of this method is that it might be challenging to determine all the costs and revenues of all the associated enterprises participating in the controlled transactions.

5. Treatment of risk after BEPS Action

The main reason why businesses take risks is that the higher the risks assumed, the bigger the return. Before the BEPS project, associated parties could shift their risk from one to another to obtain a most favorable tax for their profits[25]. The economic activity could be easily isolated from its risks associated. This has been an evidence in multinational groups that shifted risks from low-tax jurisdictions to other jurisdictions where its economic activities were existing. The BEPS Project found out that some Multinationals structures were taking economic advantage of this fact. Multinational s could create a BEPS situation by artificially allocating assets and risks to associated parties placed in low-tax jurisdictions. The actual business model could not be truly reflected because of this contractual allocation. This has been seen frequently in business models basted on intangible assets.

These business used to transfer intangible assets or the rights associated to the intangible to low-tax jurisdictions through controlled transactions. The entities located in those low-tax jurisdictions usually didn't even have capacity of control over the assets, nor over the risks associated. To benefit the whole group, those affiliates would buy the intangibles in an early stage of their development so the price paid for them would be lower due to the higher risks associated to the future of the intangible and its commercial value, that is quite harder to assess at such an early stage. Actually what usually happened is that those intangible assets transferred in that transaction were undervalued. Further to that, the associated party would claim to have part of the share of the Multinational group's income because of its obtained ownership of the intangible assets or rights associated, while in the other side, the associated party in the high-tax jurisdiction would argue that it does not have that ownership because contractually it doesn't even assume the risks associated[26].

[25] Collier, R. and Andrus, J. (2017). *Transfer pricing and the arm's length principle after BEPS*. 1st ed. Oxford: Oxford University Press, pp.211-212.

[26] Oecd-ilibrary.org. (2019). *Tax Challenges Arising from Digitalisation – Interim Report 2018*. [online] Available at: https://www.oecd-ilibrary.org/docserver/9789264293083-5-en.pdf?expires=1566753265&id=id&accname=guest&checksum=DE9F29FDDB769D0C010A76C3FEEA8BC8

6. The treatment of intangibles

Once the treatment of the risks has been explained, a good example of risk allocation is the transfer of intangibles. Intangibles are on of the most controversial items for the BEPS concern (how to consider intangibles and value them correctly). This section explains how the transfer of intangibles is analyzed by the BEPS project. The Guidelines have a broad set of general provisions that are applicable to this case, however the OECD has decided to add complementary guidelines about this matter[27].

The first concern was the real meaning of intangible. The BEPS Report defines intangible as ''something which is not a physical asset or a financial asset, which s capable of being owned or controlled for use in commercial activities, and where use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances''[28]. The essential element of this definition is that an intangible has to be susceptible of appropriation and control and that it must be something that an independent party would pay for because of its added value. The inclusion of the meaning of the word intangible was a must on the BEPS Report as a result of the complaints of the taxpayers about how associated parties were moving the ownership of the intangibles from one party to its associated without an adequate compensation and afterwards, the intangibles were giving large profits to the entity to which they were transferred. Some countries tried to find arguments to support the licitly of these intangible transfers for little or no compensations by the associated receptor. For this reason, instead of making a list encompassing all the intangibles, the OECD came up with the definition in order to prevent Multinational groups to shift valuable intangibles into low-tax jurisdictions only for tax matters[29].

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[27] Collier RJ Andrus, *Transfer Pricing And The Arm's Length Principle After BEPS* (1st edn, Oxford University Press 2017)

[28] OECD, 'OECD/G20 Base Erosion And Profit Shifting Project' (OECD Publishing 2015) <https://www.oecd-ilibrary.org/docserver/9789264241244 en.pdf?expires=1566860033&id=id&accname=guest&checksum=D26ED7800D7459C1F99116918B4E3C59>

[29] Collier RJ Andrus, *Transfer Pricing And The Arm's Length Principle After BEPS* (1st edn, Oxford University Press 2017)

The principal features of intangibles that appear in this definition are the possibility to own or control them and the effect that they have on the price of the transaction. Thee hardest issue to face about intangibles was the relation between ownership and right of profits derives from the use of the intangibles. The BEPS Report suggests that the entitlements of obtaining profits from the intangibles should be based on the contribution of each of the parties to their value. The OECD realized that the ownership of the intangible and its profit return based on contractual arrangements was not related to the party's contribution in the value of the intangible. Therefore, the Report establishes that at first instance, the owner of the intangible is the one entitles to obtain all the profits coming from its use. Nevertheless, the owner has the obligation to compensate the rest of the parties that have added value to the intangible to be in line with the arm's length principle. The Report remarks the importance of control over the intangibles and risk assumption. These two are fundamental at the time of the split of profits and the entities that carry out these roles must be well compensated for it. Since this compensation is, in the end, the same as sharing the profits, the profit-split method would fit well for this transactions. With these guides, the OECD tries to bypass the separation of profits from value creation, working to maintain the profits in line with the economic role of the associated parties in the value creation (Collier RJ Andrus, 2017).

7.1. Valuation of intangibles

The Report notices that usually intangibles are harder to value that other items due to the lack comparable availability and the uncertainty of the future real returns of the intangibles. The prior-explained methods based on comparable would not be appropriate to assess intangibles and alternative methods such as ''discounted values or projected future cash flows'' would better fit the needs to measure them. Nonetheless, the Report also contains the downside of using these alternative methods such as all the assumptions required to make the projections (growth rates, risks, useful life) and the uncertain accuracy of them. Another issue that arises when determining the value of the intangibles is that very often, these items are transferred at an early stage of their development, making this calculation more complex because of the unknown possible commercial exploitation as well as the future role of the related parties in their final development. Taxpayers argue that, due to the unpredictability surrounding the intangibles, their price should be low. However, it has been noticed that some of the intangibles make after the transfer, extraordinary profits that are usually shifted in low-tax jurisdictions because the owners of the intangibles were located there. This fact raises the question of the alleged undervalue of the initial transfer of the ownership of the intangibles (Collier RJ Andrus, 2017).

On one side, some countries wanted to allow their tax administrators to take into account the profits realized after the transfer of the intangible in order to determine the price that should have been paid for the transfer. For instance, in Germany there is a price adjustment clause because of the transfer of functions. This German transfer pricing rule works only for cross-border transactions, in this case it gives the possibility of one ex post adjustments in a 10 years' period, starting with the conclusion of the transaction. This was though to avoid that intangibles are transferred undervalued because of the uncertainty of their future profits[30]. But taxpayers and other countries have refuted that this measure ex-post is not valid under the arm's length principle because independent enterprises would not have recalculated the price afterwards (Collier RJ Andrus, 2017).

On the other side, the OECD has not wanted to leave this matter unresolved and gives the possibility of an ex-post evaluation of the conditions of the transfer as well as a revaluation to upward the price if necessary for hard-to-value intangibles. If the taxpayers wish to avoid having to pay for the allegedly unexpected profits derived from the use of the intangible, he must demonstrate to the tax authorities that this result is due to reasonably unexpected circumstances (Collier RJ Andrus, 2017).

[30] Navarro A, *Transactional Adjustments In Transfer Pricing* (1st edn, IBFD DOSTORAL SERIES 2017).

7. Intragroup financing

When analyzing the new Guidelines of the OECD it is also important to remark the treatment of the intragroup financing. As it is widely knowing, the value of a firm relies basically in three decisions: the investment choices, the financing choices and the distribution of dividends. In this chapter the main focus is on the financing. There are two ways that a company can choose to get financing: internal financing or external. Generally, the outcome is bigger when the financing is external. Whenever this is the case, there are also two options, to finance though debt or though equity. Financing with debt or equity generates some differences that must be taken into account, since both ways are valid but widely different between each other. When the debt option is chosen, the company borrows fixed amount of money from a lender to give it back after some time and adding some interests. Equity financing has another opposite way to operate, the company sells a percentage of its business to an investor in exchange for capital[31].

Typically, from a tax perspective, debt financing used to be historically more advantageous, since interests are deductible but dividends are not, this is known as the 'tax shield of debt'. However, it depends on the situation of the company and what it can do to run its business and debt has also many downsides even though is better from a tax point of view. The main difference between both ways of financing is the risk and return, commonly financing with debt gives a lower return than equity. Also de periodicity of payments, when using debt, those payments are contractually established and it corresponds to a fixed term, when using equity, the dividends can be distributing when the multinational enterprise takes that decision and there is no fixed term for this. Also in the decision making, financing through debt leaves the whole control of the business to the company, but using equity, because of the way it works, when the company sells a part of the business, the equity holder will be able to have a voice in the decision making of the company, depending on the percentage of the business it possess (Petruzzi R, 2016).

[31] Petruzzi R, *Transfer Pricing Aspects Of Intra-Group Financing* (47th edn, Wolkers Kluwer 2016)

Intra-group financing is very frequent in multinational enterprises; therefore, it must be carefully examined to prevent possible BEPS actions by the group. These transactions are analyzed with the tools that the BEPS Report provides, the methods. The first step for the application of any of them is the comparability analysis. Article 9 of the OECD Model establishes that a transaction can be arm's length where ''conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises'. In conclusion, a crucial step to verify a transaction is its comparability with another similar transaction between independent enterprises (external comparison) or between the enterprise and another unrelated party (internal comparison). The five main items to check in the comparability analysis are the characteristics of property or services, the functional analysis, the contractual terms, the economic context and the business strategies. All these aspects must be evaluated in order to determine if the price of the transaction was at arm's length and if the transaction is valid in terms of rationality. This means, that the reason behind it has economic substance and it was not made only for tax reasons. If the rationality of the transaction wouldn't be verified, the risk of corporate tax base erosion would certainly increase. There are two main situations when the tax administration would have to adjust an intra-group structure: when the economic substance of the transaction does not match its form and when the agreements made between the associated enterprises differ from the ones that an unrelated party would have made (Petruzzi R, 2016).

8. Documentation requirements (including Country-by-Country Reporting)

The impact of tax avoidance carried out by Multinational Groups structures was difficult to determine due to the lack of data available among the different jurisdictions about the allocation of the multinational's profits, sales, employees and assets, it was hard for tax authorities then to audit these companies and to analyze their transfer pricing used in controlled transactions and therefore, the fiscal consequences of tax avoidance by multinationals was not completely clear. The lack of fiscal transparency by Multinational enterprises met with the need for governments to obtain a higher income from taxes to alleviate their public sector deficit[32].

The BEPS Report adds in its Action 13, new requirements for the so-called Country-by-Country report. This Country-by-Country report's aim is to increase transparency in the multinational's operations. Multinationals will need to provide more information and there must be consistency among the master file, the local files and the Country-by-Country reports[33]. This BEPS Action 13 imposes the obligation on multinationals of preparing a report with aggregate data including the group's ''global allocation of income, profit, taxes paid and economic activity'' in each tax jurisdiction in which it operates[34].

This report is spread among all tax administrations of these jurisdictions where the multinational enterprise is present and it can be used to evaluate its transfer pricings and the allocation of risk among the companies belonging to the group.

The OECD has introduced some changes in the Transfer Pricing Guidelines to make the Country-by-Country feasible and to change national laws too, as a necessary step to oblige the parent companies of a multinational group to file, in their home country, a new Country-by-Country Reporting template that has to show generally where the profits, sales, assets and employees are and how many taxes and where are they paid. This report must be done annually and it started having effect in 2017. Multinationals now have a standard template facilitated in Action 13 to homogenize all the information so it can be easily studied. This standard from has to be shared though the CCN network. The

[32] Packman A, 'Tax Transparency And Country By Country Reporting BEPS And Beyond' (*Pwc.com*, 2016) <https://www.pwc.com/gx/en/tax/publications/assets/tax-transparency-and-country-by-country-reporting.pdf>

[33] Lang M, Storck A, Petruzzi R, *Transfer Pricing In A Post-BEPS-World* (50th edn, CPI Group 2016)

[34] 'Action 13 - OECD BEPS' (*Oecd.org*, 2018) <https://www.oecd.org/tax/beps/beps-actions/action13/>

Country-by-Country Reporting is included in the EU legislation since 2016, with the Council Directive 2016/881/EU[35].

The BEPS Action also covers any possible problem of implementation in the different jurisdictions, adding a 'Country-by-Country Implementation Package'. In order to facilitate this task, this implementation package propones some model legislation that the countries can use and three model Competent Authority Agreements.

Nowadays up to 58 jurisdictions have already implemented this Country-by-Country reporting in their domestic laws, which means that every multinational with a consolidated group revenue of 750 million euros or higher is already compelled to file the Country-by-Country report[36].

There is an exemption for multinationals with a consolidated group revenue under the 750 million euro (or the equivalent amount of money in another currency) during the precedent fiscal year. This exemption has been included for two main reasons, on one side, it excludes most of the multinational groups that operate worldwide, nevertheless it encompasses the few amount of multinationals that control almost 90% of the world's total corporate revenue (Lang M, Storck A, Petruzzi R, 2016). On the other side, it also eases the administrative burden of multinational groups[37].

Prior to the appearance of the last edition of the OECD Guidelines, the requirements of sharing tax information for the Multinationals was subjective. They just needed to present the data they found as reasonably necessary to demonstrate the following of the arm's length principle in their businesses with the associated enterprises. These previous Guidelines did not encompass a clear list with all the items that multinationals should include in their reports. After 2017, the OECD implemented three required types of information gathering standard that multinational groups would need to respect. This

[35] 'Country By Country Reporting - Taxation And Customs Union - European Commission' (*Taxation and Customs Union - European Commission*, 2019) <https://ec.europa.eu/taxation_customs/business/tax-cooperation-control/administrative-cooperation/enhanced-administrative-cooperation-field-direct-taxation/country-country-reporting_en>

[36] 'Action 13 - OECD BEPS' (*Oecd.org*, 2018) <https://www.oecd.org/tax/beps/beps-actions/action13/>

[37] COUNCIL DIRECTIVE (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation 2019

change had three main objectives: First, it helps taxpayers to determine their Transfer Pricing risk profile; second, it provides tax authorities with a useful set of tools to examine the Transfer Pricing of the multinationals and it supports them in case of a Transfer Pricing audit, assuring that taxpayers will be able to provide the necessary documentation[38].

The Master file is a document that furnishes valuable information about the whole global business and the Transfer Pricing policy of the group. It gives standardized information about the group's organizational structure, main value drivers, where the associated parties are located and a description of the economic activities of the entities of the group (products, services, supply chain, etc). it also provides data about the group's financing, intangibles and funding, as well as tax positions of the whole group. This file should be spread among all tax jurisdictions where the entities of the group are resident (Olanrewaju A and Seun A., 2018)

The local file is more focused on sharing information about the activities of the entities in their local jurisdictions and the local entity's controlled transactions. It is filled with the tax authority in that country. Local files give additional information to the master file, showing more precise information of the local associated entities in those jurisdictions (Olanrewaju A and Seun A., 2018).

The objective of the Country-by-Country report if perfectly understandable and lawfull, however it is not exempt from controversy. The main concern of this active collaboration among countries through the exchange of fiscal information is the issue of the confidentiality of certain data such as trade secrets or some financial information among others. There are considerable dissimilarities between jurisdictions about the treatment of tax secrecy, therefore multinationals have no guarantee that all of them will keep the information confidential. There are even some countries sich as France, Norway or Swede where tax data is publicly available (Lang M, Storck A, Petruzzi R, 2016).

[38] Olanrewaju Alabi and Seun Adu, 'Pwc's Transfer Pricing Series Master File, Local File; What You Need To Know' (*Pwc.com*, 2018) <https://www.pwc.com/ng/en/assets/pdf/tp-masterfile-localfile.pdf>

9. OECD role: the harmonization of international tax law

The issue of the BEPS has its origins in the differences of the tax jurisdictions all around the world. In a smaller context, even the European Union, which counts with a Internal Market inside of its barriers and joins their EU Member States forces to compete with the other countries all around the world, has disparity in their Member States' domestic tax laws[39].

This opens the possibility of a BEPS behavior by multinational enterprises. For this reason, some attempts of a common corporate tax have been discussing in the European Union. The EU is treated as a single market but this market is not fully harmonized in terms of taxes. One opinion is that this would make it easier the cross-border activity of the multinationals, enhancing their competitiveness to the exterior. Nowadays, corporate income is taxed at a national level but the contexts in which these multinationals work is worldwide. The business structures of multinational groups are more and more complex and profit shifting has become a big issue for all countries. The European Commission has proposed in 2016 a new framework to enhance the protection of Europe of the BEPS (European Commission, 2015).

The Commission notices that companies look at the EU as a Single Market but they have to comply with 28 different tax systems, which is costly in terms of time and money spent. Also these businesses usually can profit out of the divergence among jurisdictions. Some national rules for corporate tax don't take into account international business, leaving the door open for BEPS to the multinationals, that take advantage also of the mismatches of the tax agreements between countries and of the different taxes and domestic laws, leading to situations of either double taxation or even double non-taxation. This situation translates into the fact that the Member States are not adequately compensated by the companies that take advantage however, of their public infrastructure. Likewise, it causes

[39] 'Re-Launch Of The Common Consolidated Corporate Tax Base (CCCTB)' (*Ec.europa.eu*, 2015) <https://ec.europa.eu/smart-regulation/roadmaps/docs/2016_taxud_006_ccctb_rm_en.pdf>

other businesses that do not have enough resources to carry out an aggressive tax planning, to see themselves in a disadvantaged position (European Commission, 2015).

On the other hand, and on the basis that the Commission wants this harmonization in Corporate income taxes, there are many detractors to this initiative. Opponents use other counterarguments for which fiscal harmonization in the European Union is not a good idea. The first argument is the loss of national sovereignty in favor of the union, yielding both monetary policies due to the unification of the currency in Europe, as well as fiscal ones. Opponents use other counterarguments for which fiscal harmonization in the European Union is not a good idea. The first argument is the loss of national sovereignty in favor of the union, yielding both monetary policies due to the unification of the currency in Europe, as well as fiscal ones. In addition, the tax harmonization could be the previous step to a tax harmonization, unwanted by several member states of the union. The establishment of a common corporate income tax poses a threat to the sovereignty of States. In continuity, unification could also be extended in other areas in which members retain a certain sovereignty, such as security, which could eventually lead to a total loss of national sovereignty in favor of the European one[40].

The opinion of the commission about a posible tax harmonization sd positive, and it also makes sense taking into account the creation and development of a Single market. However, nowadays the Member States have more freedom to chose their internal tax systems, and some states like this freedom because it enhances also competition at the time of attracting corporate or individual investments to them, so that they can tax those incomes inside of their jurisdictions. On the other side, the Single Market was created to eliminate all obstacles in cross-border economic activity and, although it should include tax obstacles, this is an issue that hasn't been resolved yet.

What it has been developed is an increase of the transparency of information among countries around the world, which helps them to better detect the cases in which multinationals are taking too much advantages of the Double Tax Treaties (practice

[40] Austrian Economics Center, 'A Response To The European Commission The EU'S Push To Abolish Unanimity On Tax Policy Should Be Rejected' (Austrian Economics Center 2019) <https://www.austriancenter.com/unanimity-on-tax-eu/> accessed 29 August 2019

known also as Treaty shopping), where they see how to avoid paying taxes using gaps among jurisdictions, which can also lead to a Double non-taxation. Therefore, and even if there is no harmonization, the measures taken agains tax avoidance are giving already good results and are in line with a more fair competition between enterprises. Step by step, enterprises need also to justify their intra group transactions, and to demostrate that their business structures have substance, this means, they are not made only due to fiscal reasons. This framework is changing at a fast speed and multinationals are adapting also to this new regulations and controlled, preparing the necessary documentation in order to explain all their transactions to the authorities.

Although a tax harmonization would be hard in terms of acceptance and in terms of competition, the current advances in the international and national laws are leading to a minimization of the tax avoidance by the multinational enterprises, which is the main objective of all this developments and discussion.

The European Commission is however, in favor of equalizing the national tax jurisdictions in all Member States, but it is unlikely that some of them would accept this. The Commission has already launched a Common Consolidates Corporate Tax Base (CCCTB) proposal to enhance the effectiveness in the controlled of the taxes paid by the MNE in the EU. This would remove some tax obstacles in the single market and, besides, it would make it easier for MNE to comply in all tax systems, reducing their compliance costs due to the differences among the multiple jurisdictions. It would also alleviate the work load of the tax administrations and the taxpayers, while ensuring that they are getting their due tax revenues. All these consequences would lead to a decrease of the tax avoidance by the taxpayers (though base erosion and profit shifting actions and possible Double non-taxation, as well as through aggressive tax planning).

Viewing the diverse opinions of the Member States related to this tax harmonization incentives, the better option and what all countries are trying to do is to increase cooperation and transparency by sharing information and acting against these practices together, but maintaining their freedom to regulate their national taxes.

Member States of the European Union are, therefore, free to rule their taxes as long as they comply with the EU jurisdiction. At the same time, they are facing a stronger competition determined by the fast process of globalization in the economy where all States want to incentive corporate investments to happen inside of their borders. Tax competition favours some countries in detriment of others, so in this contexts, corraboration and competition must be kept at balance. The digitalisation of the economies is also generating new business models that have a strong effect in the ovrall economy and it makes it more difficult for tax administrations to control how multinationals work all around the world. This causes the need of modernize the tax systems in order to tackle posible beps practices by the multinationals. Multinational will always look for the most favourable conditions for their growth, so they will always try to find a way to pay less taxes on their total global revenue, and although this is a common practice, tax administrations must count on the right to tax the income that has been created inside their barriers in order to be able to provide growth as a country.

10. Transfer Pricing case: Case Starbucks

After studying the different transfer pricing methods proposed by the OECD, it is possible to exemplify the impotence of reviewing intragroup operations in various cases. One of the most controversial recent cases that is directly related to this issue is the Starbucks case in the Netherlands. The EU Commission has recently imposed on Starbucks the obligation to return 30 million euros for unpaid taxes accrued since 2008. This duty is not a penalty, but not the taxes owed along with its late payment interest. There are several opinions about this measure since what the multinational has saved in the payment of taxes corresponds to a much higher amount than 30 million euros[41].

Starbucks, the North American company whose headquarters are in the Netherlands, was

[41] Byrnes W, W HaslehnerG Teijeiro, 'The Netherlands Appeals The Starbucks Decision - Kluwer International Tax Blog' (*Kluwer International Tax Blog*, 2015) <http://kluwertaxblog.com/2015/12/09/the-netherlands-appeals-the-starbucks-decision/>

established there after negotiating a series of agreements, known as Advanced Pricing Agreements or 'APA' for its acronym, whose objective was to reduce the tax base of Starbucks in the Netherlands. To achieve this goal, the multinational used two ways: on the one hand, it paid premiums for coffee beans to a subsidiary in Switzerland; and on the other he paid royalties for the use of technology knowledge to a subsidiary in the United Kingdom. The Dutch government allowed the multinational to divert its profits through transfer prices that did not respect the arm's length principle. This involved tax aid, which gave Starbucks a huge competitive advantage, violating European regulations and taking advantage of the lack of fiscal harmonization within the union. Following these types of cases, the commission is considering fiscal harmonization within the member states of the European Union, as explained in the previous chapter (Byrnes W, W HaslehnerG Teijeiro, 2015).

11. Conclusions

As it has been explained in this thesis, Transfer Pricing has become important in these recent years. It is true that there were already some publications about the arm’s length principle that intra group transactions should follow but it wasn’t until the globalization era that this has become a subject of broad interests worldwide. There are some countries in the European Union that did not even have a control on this prices, letting multinationals profit from the mismatches in the Double Tax Treaties, as well as from the local regulation.

After this thesis it is possible to corroborate how transfer pricing is now located in the spot light of the tax authorities and how the international organizations are taking measures against possible BEPS from the multinationals. It has been demonstrated that, thought these practices, multinationals have reallocate their income in low tax jurisdictions and how, because of that, the global loss profit in collection of tax revenue has raised up to $240 billion of loses each year, which is equivalent to 4-10% of the global corporate income tax revenue[42], due to this reallocation of income that affects all countries. This is generated though many practices, but the most common ones are the transfer of intangibles and the intra group financing activities, where the downstream the loan through the related parties.

Depending on the country and the specific treatment given to these operations, Multinationals develop some of these activities. Transfer of intangibles is somehow, harder to tackle because of the unpredictability of the returns, such as the future benefits that this intangible will bring to the group. Companies may transfer the intangible at an early stage of its development, making it more difficult for the tax authorities to assess its real future value and, therefore, underestimating it most of the time. This practices causes that in the end, the price paid for the intangible is too low. Usually the intangible is transferred from one country to another low tax country. Afterwards the intangible starts giving benefits to the group, earning that will be registered in the low tax country, and therefore decreasing considerably the total group payment in taxes because of a double effect. First, the costs that the company faces in R&D are realized where the intangible is created, in the higher tax country, lowering the tax base of the group entity in that country. After the sale, the earnings in this country will only be the price paid for the intangible, but the benefits, that will probably be weight greater than the price, will be taxed in the low tax jurisdiction. This is a very common practice in multinationals and there have been lots of efforts to tackle this practice. One very famous is to be able to review the price some time after the sale of the intangible. However, this has been criticized by some companies as well as tax authorities because it would be against the arm's length principle. Independent companies don't review the price of a transaction after doing it, therefore, associated enterprises should not do that. The valuation of intangibles is still a subject undergoing intense study and a difficult obstacle for tax authorities to control the avoiding of taxes by the multinationals.

Another typical transaction between companies of the same group is the intra-group financing activities. This procedure consists basically in lending loans from one company to another company of the same group in exchange of an interest rate that must cover the

[42] Bradbury, D., Hanappi, T. and Moore, A. (2018). *Estimating the scal effects of base erosion and pro t shifting: data availability and analytical issues*. [online] Unctad.org. Available at: https://unctad.org/en/PublicationChapters/diae2018d4a6.pdf

risks that the company that lends the money incurs in this operation as well as an adequate remuneration for the intra group financing activity that this company performs. This practice in Europe is well known to be developed in Luxembourg, many companies have there their headquarters or a holding to perform these activities while profiting a good tax treatment. Before 2010, no transfer pricing rules were being imposed to these operations, but the OECD has realized the tax minimization of multinationals that were using this practices and the have established some minimum requirements in order to control that the intra group financing activities are at arm's length. The focus of the tax authorities is in two main requirements:

- First, the company that lends the loan to the associated entity must have a minimum amount of equity to cover the risks;
- Second, the lender company must receive a fair remuneration for the activities performed according to the arm's length principle, and it also must have some substance, meaning some prepared people in the country that can take decisions about the activities and have enough knowledge to manage the risks of the loans.

These requirements are imposed to avoid that this intra group financing activities are just an excuse to reallocate the earnings of the company in order to pay less taxes, in some countries, and for instance Luxembourg is one of them, interests are deductible. What this means I that, prior to the establishment of these two requirements, the interests rate imposed on the intra group loans were excessively higher and led to a fictional allocation of the income. Nowadays, with the new regulation, the interest must correspond the operation itself, taking into account all the characteristics of the loan itself and the borrower, such as the credit rate of the loan, the maturity, if there is a pre payment option, the seniority if the loan, the type of industry and the general terms and conditions of the transaction itself. To establish an appropriate interest rate, the operation must be thorough analyzed, from a functional analysis to an economic one and comparing the analysis to some other similar transactions in order to settle a range of interests in which the operation must be developed.

In conclusion, it is possible to observe that many advances have already been made at the global level in the regulation and control of international taxation in multinational enterprises, more and more, the different jurisdictions are becoming increasingly better coordinated to prevent groups of companies evade taxes through these practices explained above. The European Commission is beginning to propose a possible European tax harmonization, but this Project is, for now, only one approach and many countries of the union are against these practices, fearful that they lead to a departure from corporate income from the European union to third countries due to this threaten harmonization. For now, differences in tax treatment in jurisdictions continue to prevail throughout the world due to both historical and economic reasons, and, although large multinationals benefit from them and the lack of coordination still existing between countries, it is sought that The overall tax collection on their benefits is minimally fair, both for tax authorities and for their actual and potential competitors. With the current information the great doubt remains of what would be an appropriate solution for this scenario. Possibly a fiscal harmonization would lead to greater justice at a global level, but the potential tax losses of some countries would make it very difficult for them to accept this change, refusing to change their internal legislation in favor of a more just global legislation, since they would lose competitiveness when it comes to attract corporate income. The dilemma will continue and in the following years this international normative will continue to be developed and the countries will have to adapt to it[43].

[43] 'Common Corporate Tax Base (CCTB)' (2016) <http://www.europarl.europa.eu/RegData/etudes/BRIE/2017/595907/EPRS_BRI(2017)595907_EN.pdf>

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Abstract

In this thesis, the various causes behind the OECD's recent regulation about transfer pricing will be raised. The reasons why transfer pricing rules must exist and why it is currently gaining importance. Countries are nowadays facing the need to collaborate in order to tackle the dreaded reallocation of taxable income. Multinationals have created complex business structures in order to minimize their taxes, and transfer pricing has a primary role in these practices.

The thesis will begin by contextualizing the recent normative to understand how it has been changing according to the socio-economic global background. Afterwards, an introduction of the OECD legislation for the determination of the transfer pricing will follow, and each of the methods proposed by the OECD for the determination of the transfer prices in the intra-group operations will be explained. It will analyze each method one by one, how and when each of them must be used and how to choose the most appropriated one depending on the characteristics of the transaction. Further to that, an analysis of the most relevant intragroup operations will be carried out, focusing on the transfer of intangibles between related entities and the intra group financing activities. Finally, the recent case of transfer pricing in the Starbucks group will be examined.

Once these various aspects have been analyzed, in the conclusions it will be a debate if the recent regulation of the OECD and the intention of cooperation among countries, increasing the fiscal transparency of the multinationals, is or not sufficient to combat the reallocation of income for fiscal reasons or it will be necessary to go further.

Abstrakt

In dieser Arbeit werden die verschiedenen Ursachen für die jüngste Verordnung der OECD über Verrechnungspreise angesprochen. Die Gründe, warum Verrechnungspreisregeln existieren müssen und warum diese aktuell an Bedeutung gewinnen. Heutzutage müssen die Länder zusammenarbeiten, um die gefürchtete Umverteilung des steuerpflichtigen Einkommens in den Griff zu bekommen. Multinationale Unternehmen haben komplexe Geschäftsstrukturen geschaffen, um ihre Steuern zu minimieren, und Verrechnungspreise spielen bei diesen Praktiken eine wichtige Rolle.

Die Dissertation beginnt mit einer Kontextualisierung der jüngsten Normative, um zu verstehen, wie sie sich angesichts des sozioökonomischen globalen Hintergrunds verändert hat. Anschließend wird eine Einführung in die OECD-Gesetzgebung zur Ermittlung der Verrechnungspreise gegeben und jede von der OECD vorgeschlagene Methode zur Ermittlung der Verrechnungspreise im gruppeninternen Geschäft erläutert. Dabei wird jede Methode einzeln analysiert, wie und wann sie angewendet werden muss und wie die am besten geeignete Methode in Abhängigkeit von den Merkmalen der Transaktion ausgewählt wird. Darüber hinaus wird eine Analyse der wichtigsten konzerninternen Operationen durchgeführt, die sich auf den Transfer von immateriellen Vermögenswerten zwischen verbundenen Unternehmen und die konzerninternen Finanzierungsaktivitäten konzentriert. Schließlich wird der jüngste Fall von Verrechnungspreisen in der Starbucks-Gruppe untersucht.

Nachdem diese verschiedenen Aspekte analysiert wurden, wird es in den Schlussfolgerungen eine Debatte sein, ob die jüngste Verordnung der OECD und die Absicht der Zusammenarbeit zwischen den Ländern, die steuerliche Transparenz der multinationalen Unternehmen zu erhöhen, ausreichen oder nicht, um die Umverteilung von Einkommen zu bekämpfen steuerliche Gründe oder es wird notwendig sein, weiter zu gehen.