BEPS TRANSFER PRICING WORKSHOP

TRANSFER PRICING DOCUMENTATION – RISK ASSESSMENT AND SAFE HARBOURS

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26 – 30 OCTOBER 2015

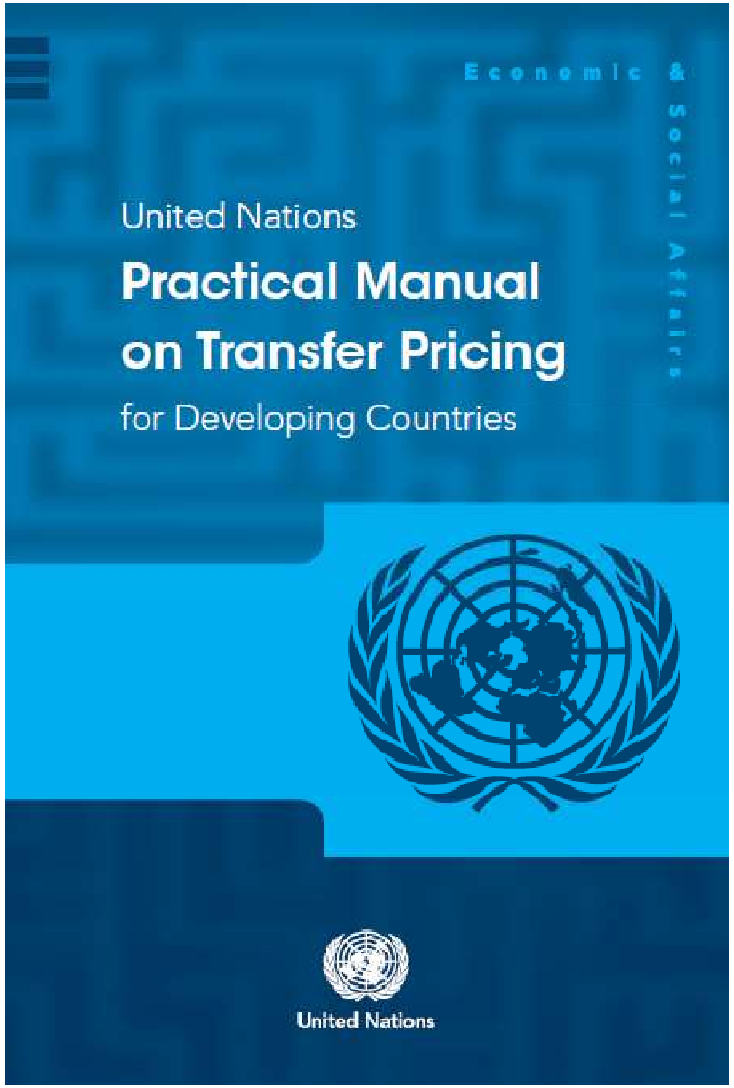
12. New Guidance on Safe Harbours

OECD
BETTER POLICIES FOR BETTER LIVES

Guidance – Where to find?

- OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
  - **Chapter IV** – Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes
    - **Section E – Safe Harbours**
- Published: 16 May 2013
- UN Practical Manual on TP for developing countries – Section 3.8

http://www.un.org/esa/ffd/documents/UN_Manual_TransferPricing.pdf



Why OECD development of new guidance?

- 1995 TP Guidelines on Safe Harbours were no longer in sync with country practices: rather negative recommendations but countries use safe harbours
- Safe harbours can be particularly useful for emerging economies
- Simplicity and enhancing compliance

Safe harbours and emerging economies

- Safe harbour rules can be an attractive option for developing countries, mainly because they can provide predictability and ease of administration of the transfer pricing regime by a simplified method of establishing taxable profit.
- **Advantages**
  - low compliance costs and
  - certainty for taxpayers, as well as
  - administrative simplicity for tax authorities

(UN Practical TP Manual for developing countries)

Key message 1

"The appropriateness of safe harbours can be expected to be most apparent when they are directed at taxpayers and/or transactions which involve low transfer pricing risks and when they are adopted on a bilateral or multilateral basis." [Para. 4.96]

Key message 2

"Although safe harbours primarily benefit **taxpayers**, by providing for a more optimal use of resources, they can benefit **tax administrations** as well." [Para. 4.97]

Key message 3

"However, the design of safe harbours requires **careful attention** to concerns about the degree of approximation to arm's length prices..., the potential for creating inappropriate tax planning opportunities..., equitable treatment of similarly situated taxpayers, and the potential for double taxation..." [Para. 4.97]

Definition of transfer pricing safe harbours

A safe harbour in a transfer pricing regime is a provision:

– that applies to a defined category of taxpayers or transactions, and

– that relieves eligible taxpayers from certain obligations otherwise imposed by a country's general transfer pricing rules.

Consequences of transfer pricing safe harbours

- ✓ Allows taxpayers to establish transfer prices in a simplified way
- ✓ Could exempt certain taxpayers or transactions from the application of general transfer pricing rules

Benefits of safe harbours

- ✓ Simplifying compliance and reducing compliance costs for eligible taxpayers
  - Especially where transfer pricing risks are small, and the burden of compliance is disproportionate
- ✓ Providing certainty to eligible taxpayers
- ✓ Permitting tax administrations to redirect their administrative resources
  - Secure tax revenues in low risk situations with a limited resources
  - Concentrate on the examination of more complex or higher risk cases

Benefit – Compliance relief

- May avoid costly, difficult to obtain and disproportionate collection and analysis of data
- Ease compliance burden

Benefit – Providing certainty

- Certainty that the taxpayer’s transfer prices will be accepted provided the eligibility conditions have been met
- Potential publication of parameters to deem an appropriate transfer price.

Benefit – Administrative simplicity

- Eligibility for safe harbours still needs to be verified but need not be done by experienced TP auditors
- Once eligibility established: only minimal examination needed → allows to concentrate on complex or high risk transactions
- Increased compliance of taxpayers that would not be under scrutiny.

Concerns over safe harbours

- Divergence from the arm's length principle
- Risk of double taxation, double non-taxation, and mutual agreement concerns
- Possibility of opening avenues for tax planning
- Equity and uniformity issues

Concerns – Non-arm’s length approaches

- Divergence from the arm’s length principle
  - May not correspond to the most appropriate transfer pricing method to the circumstances of the case
  - Do not fit exactly the facts and circumstances of individual taxpayers
  - Option for the taxpayer to elect the safe harbour, but potential loss of tax revenue where taxpayers pay only lesser amount
  - Opt in and opt out when favourable

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Concerns – Double (non) taxation and MAP

- Risk of double taxation, double non-taxation, and mutual agreement concerns
  - Safe harbour parameters set to increase tax revenue
    - Overstatement of income
    - Penalty related
  - Safe harbour parameters below arm's length level
- Modification of safe harbour outcome through Mutual Agreement Procedures
- Creation of bi- or multilateral safe harbours

Concerns – Opening tax planning opportunities

- Possibility of opening avenues for tax planning
  - Splitting transactions in two or more transactions to make them simple or small
  - Taxpayers with profitability better than safe harbour based on industry average
    - Example: cost efficient company earning 15 pct. on sales where safe harbour adopts 10 pct. on sales, based on industry average

Concerns – Opening tax planning opportunities

- Potential solutions
  - Bilateral or multilateral safe harbours, but, may need to address “safe harbour shopping”
  - Narrow ranges of safe harbour parameters
  - Consistent reporting of income in each country
- Trade-off between simplicity and potential tax revenue erosion

Concerns – Equity and uniformity

- Creation of two distinct sets of rules: the normal “arm’s length” rules and the safe harbour rules for qualifying companies
- Preferential tax regime could create
  - discrimination,
  - divergence in tax treatment and
  - competitive distortions

Recommendations on use of safe harbours

1. Properly designed safe harbours can relieve compliance burdens and provide certainty
2. Safe harbour provisions may raise several issues, and unilateral safe harbours may lead to double taxation or double non-taxation
3. In cases involving smaller taxpayers or less complex transactions, the benefits may outweigh the problems
4. Making safe harbours elective to taxpayers can limit the divergence from arm's length pricing

Recommendations on use of safe harbours

5. Willingness to modify safe-harbour outcomes in MAPs to limit double taxation is advisable
6. Use of bilateral or multilateral safe harbours should be encouraged
7. A safe harbour is in no way binding on or precedential for countries which have not themselves adopted the safe harbour
8. Benefits and concerns should be carefully weighed in making use of safe harbours

Q & A