

Transfer Pricing covers the structuring of transactions and financial relationships of Multinational Enterprises. Tax planning in the area of transfer pricing tends to be focused in the creation of transaction structures which can justify tax efficient profit allocations.

Currently, controlled transaction structures have received great attention from the OECD and domestic tax administrations and there is a need for guidance in this area.

As the transaction structure will affect the transferor's and transferee's profits, the restructuring of a controlled transaction will affect the arm's length price and will differ from the actual controlled transaction as different transaction structures will result in different prices.

The first step is to recognize the controlled transaction undertaken by an associate enterprise and the second step is to recognize the extent to which the arm's length principle gives authority to the tax administrators of a country to restructure the controlled transaction<sup>1</sup> in order to have the transaction as a base for any further adjustments or valuation.

The use of the arm's length principle attempts to ensure: a) a consistent basis for profit allocation b) helps to prevent MNEs from suffering economic double taxation, taxation of the same profit by more than one tax administration c) provides broad parity of tax treatment for MNEs and domestic corporates, preventing distortion of their relative competitive tax positions.

Both unrelated and associated enterprises will structure their contractual relationship in different ways, however, associated enterprises may enter into transactions which independent enterprises would not undertake.

An example is, where the Tax Court of Canada has agreed with the tax authority that the 'implicit guarantee' needs to be considered in respect of the relationship between the affiliates. The value added by virtue of the explicit guarantee was significant enough to merit the payment of a fee in *General Electric Capital Canada Inc. v The Queen (Canada)*<sup>2</sup> case.

Further, contractual arrangements are the starting point to determine which party to a transaction bears the risks associated as the examination of the allocation of risks between associated enterprises is an important part of the functional analysis. Under Article 9 of the OECD Model Convention in respect to Taxes on Income and on Capital, the examination of risks starts with the examination of the contractual terms.

When a risk assessment is undertaken there are several key areas that are examined, including<sup>3</sup>:

1. The business model of the MNE is examined, including analysis of the key function providers, asset holders and risk takers of the group.
2. The share price strategy of the group is monitored.
3. Local profit margin is analysed in reference to that company's activities

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<sup>1</sup> OECD Guidelines Para.1.65

<sup>2</sup> *General Electric Capital Canada Inc. v The Queen (Canada)*

<sup>3</sup> OECD, 2012, *Dealing Effectively with the challenges in Transfer Pricing*

within the group and compared with the group profit margin, to identify whether this rate is in line with the group as a whole.

4. The tax rates of the countries in which the group operates are examined, in order to determine whether there is an incentive for moving profits around the MNE.
5. The effective tax rate in each country is compared with the standard rates present in each country and if there are any significant differences, it is examined.

However, the OECD Guidelines leave a number of issues unresolved and unaddressed and as Bakker and Cottani (2008) state: 'tax literature in Transfer Pricing is not very extensive'. The conditions for restructuring a transaction referred to in the OECD Guidelines in paragraph 1.65 are not entirely clear. Therefore, an in depth examination of the challenges needs to be addressed as the OECD Guidelines leave a number of issues unresolved and are not dealt with in any other OECD publication.