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Transfer Pricing and Tax Certainty: Telling Your Own Business Story

Transfer pricing analysis has traditionally been dependent on the "comparability analysis" that refers to the criteria by which comparables are evaluated to establish an arm's length outcome. In straightforward cases such outcome can be derived based on the results of the empirical analysis of third-party transactions (also referred to as benchmarking study). However, related parties may enter into transactions that third parties would usually not undertake, such as financial transactions or transactions involving intangibles, which are unique for each multinational group, that makes it difficult for comparability analysis to be applied.

In view of the increasingly integrated operations of multinational companies and the emergence of new technology-based industries, a solution to the problem of insufficient or unavailable comparables can be found in the hypothetical analysis, which may enhance the empirical search for comparables, or even substitute it.[1] For example, if a highly integrated transaction, for which no comparables exist, needs to be tested on its compliance with the arm's length principle, the empirical test could still be applied, but just to give an indication of what is the return that could normally be earned on the market (i.e. routine return). The empirical test must then be followed by the hypothetical test in order to identify *what* is the "over and above" return and *how* such extra return (i.e. a synergetic gain[2]) should be allocated within a multinational group.

The OECD commits itself to add the hypothetical examples to its Transfer Pricing Guidelines with the aim "to assist in interpreting principles and in addressing difficult issues already discussed in the Guidelines". [3] According to the OECD, "[a]lthough hypothetical, the examples will draw on the practical experiences of tax administrations and taxpayers in applying the arm's length principle under the Guidelines, and will contribute to the establishing of good practices." [4] As such, the hypothetical comparability analysis, if properly documented (being essentially your own business story), could serve as a solution for transfer pricing analysis of highly integrated business models.

Yet the question of whether we really need the comparability analysis, or would it rather be enough to approach all intercompany transactions with a formula to split the intra-group profits, is still relevant to ask. The strong argument *in favour* of the arm's length principle is the argument *against* the formulary apportionment – a single formula would not be possible in a cross-border situation as countries would not be willing to give up on their right to tax (what they believe is) their share of intra-group profits just because of different combination of factors in such formula in every single transfer pricing case.

At the same time, the weakest point of the arm's length principle is its varying interpretation by many jurisdictions, which leads to uncertainty in the application of the principle itself and to tax uncertainty in general. The way to achieve greater certainty in tax and transfer pricing, especially post-BEPS, is through effective dispute avoidance and resolution mechanism, including unilateral rulings and advance pricing agreements (APAs), enhanced cooperation programs, and mutual agreement procedures (MAPs).

[1] Pankiv, Contemporary Application of the Arm's Length Principle in Transfer Pricing, IBFD 2017, pp. 179-180
[2] Id., pp. 182-183
[3] OECD Guidelines, Annex to the OECD Transfer Pricing Guidelines: Guidelines for monitoring procedures on the OECD Transfer Pricing Guidelines and the involvement of the business community, Section B.4, para.16
[4] Id.