



FINAL REPORT ON BEPS – A NEED FOR ACTION REGARDING FUNCTION AND RISK ANALYSIS!

The fight against base erosion and profit shifting (BEPS) is dominating the world's taxation agenda. In excess of 12,000 pages of public comments on the Discussion Drafts have accumulated since publication of the OECD BEPS Action Plan on 19 July 2013. On 5 October 2015, the OECD published its Final Report, which contains far-reaching reforms of the OECD Transfer Pricing Guidelines (TPGs). One of the main goals of the OECD in embarking on the BEPS project was to align transfer pricing outcomes with value creation (Actions 8-10). In this context the mantra of consistency between function & risk analysis and profit allocation played a decisive role. This aspect is reflected in a revision of guidelines on intangibles to prevent the allocation of profits to an associated enterprise solely based on its legal ownership of intangibles, or implementing rules to ensure that inappropriate returns will not accrue to an entity solely based on contractually assumed risks and capitalisation that lacks economical substance. The fundamental issues in examining profit allocation between associated entities include the functions that are actually performed, the assumption and control over risks, and the contribution of assets. Contractual arrangements have become less important; according to the OECD, they shall henceforth provide the starting point in conducting a transfer pricing analysis.

Implementation of the BEPS reforms will up the ante. Tax authorities are likely to demand a more detailed documentation of an entity's contribution to the value chain of an MNE. In cases where the economic substance of a transaction, the value added or the corresponding classification of an entity or of specific services cannot be substantiated, tax authorities will be more likely to push for transfer pricing adjustments. In this context, preparing a detailed function and risk analysis will establish a cornerstone, and will greatly enhance the tax viability of existing and future transfer pricing systems. Particularly for integrated business models and those being centred on utilising intangibles, taxpayers should devote additional efforts to determine a plausible categorisation of their group entities. In order to substantiate the categorisation, the taxpayer can compile a file of relevant documents (i.e. internal memos, correspondence, and job description), which can be utilised to illustrate operating processes. Respective documents are ideally to be filed contemporaneously, as it is often difficult to procure these retroactively. While all this

admittedly sounds somewhat boring and may well be perceived as an unwelcome drain of resources by unproductive compliance work, a more conscientious approach to transfer pricing could eventually yield some tangible benefits. Among the potential low-hanging fruits the following ones arguably stand out:

- Mitigating tax risks by avoiding reclassification and testing the tax viability of the applied transfer pricing methods
- Providing a solid basis for compliance as well as for future re-structuring
- Uncovering potential savings from both the economic and tax perspective
- Fostering mutual understanding between group operating units
- Providing a spark to promote discussions between tax and controlling departments

While complex and wide-ranging, for many taxpayers the BEPS reforms need not cause too much alarm. Considering that the tax climate is changing for the worse, however, it is not the time for complacency either. As a taxpayer you should be prepared to explain in which way your transfer pricing system ensures that each entity is allocated a share of the group profit that is proportionate to the value added attributable to the functions performed by that entity. If you do not have the answer ready, it may not be a bad idea – sooner rather than later – to start revisiting your functional and risk analysis, as you can be sure that these questions will eventually come up during tax audits.



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