Transfer Pricing Forum

Transfer Pricing for the International Practitioner

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In the light of the BEPS project, high profile international court decisions and apparent trends in your own tax jurisdiction, how do you see the future of transfer pricing in your jurisdiction, and why?

1. Which tools of transfer pricing planning may be affected – for example, the shifting of intangibles, finance or risk?

In the post-BEPS environment, an overriding priority of multinational businesses is to align transfer pricing arrangements with the BEPS measures by ensuring that contractual arrangements are not misaligned with economic realities and that intangible revenue streams are supported by relevant functions. Certainly, multinational businesses are reconsidering the sustainability of their transfer pricing positions in light of the new measures. It seems that certain businesses are even willing to change their transfer pricing policies and accept the reallocation of profits to higher tax jurisdictions, if necessary, in response to the BEPS measures and the intensified focus on cross-border transfer pricing.

For transfer pricing profit allocation purposes, BEPS Actions 8-10 has made it clear that risks and intangibles cannot be contractually isolated from functions. Accordingly, aggressive planning, such as restructuring contractual risk transfers to offshore profit hosting entities with no or minimal functions, could indeed be a thing of the past. For now, multinational businesses, including those with operations in Denmark, are generally focused on adherence to the new guidance in order to reduce double taxation exposure, disputes and, not least, bad publicity. We do not see it as likely that the possible new planning opportunity created by BEPS, that is, restructuring to transfer actual functions (substance) to low-tax jurisdictions, will be embraced by many MNE groups. Indeed, the transfer of functions can be difficult to implement commercially and potential jurisdictions that are favourable in terms of corporate taxation may not have the infrastructure needed to support the business operations.

Although the BEPS project will likely not mean the end to controversial transactions and planning strategies, multinationals are certainly aware of the increased level of exposure. This is particularly true in Denmark where multinationals should expect a robust application of the BEPS transfer pricing measures in the event of audit.

2. Could there be more interest in ensuring that there is sufficient substance to match the contractual roles of group companies?

There will clearly be an enhanced focus on ensuring that written contractual terms conform to the parties' conduct and that intra-group agreements are aligned with the underlying factual substance of the transactions. As it has been the case long before the launch of the OECD/G20 project to fight base erosion and profit shifting, the Danish tax authorities do not accept the terms of written contracts for transfer pricing purposes automatically and may indeed inquire into the facts surrounding the arrangement, including the day-to-day performance of the agreement, decision-making procedures, etc. The BEPS measures are likely to lead to an increase in disputes over contracts versus conduct, considering that proper delineation is decisive for the transfer pricing assessment of transactions. If a transaction is delineated contrary to the parties' understanding and assumptions (reflected and memorialized in a written contract), this may render the parties' method selection and comparability analysis flawed. Moreover, it may result in an unintended tax treatment and qualification of the arrangement under Danish domestic tax laws (e.g., capital gains taxation).

Enhanced focus on aligning contracts with conduct may result from the BEPS documentation standard. Contrary to the Danish pre-BEPS transfer pricing documentation regulations (laid down in Executive Order No. 42 of January 24, 2006), copies of all material intercompany agreements concluded by a Danish group member must now be disclosed in the transfer pricing documentation (local file) pursuant to the Danish BEPS documentation regulations (laid down in Executive Order No. 401 of April 28, 2016).

3. In which ways might the burden of transfer pricing documentation change, for example by the inclusion of global value chain analyses or a review of the financial transactions of the group?

The Danish pre-BEPS transfer pricing documentation regulations include fairly detailed requirements. Spe-

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cific items are required, such as a description of the group and the commercial activities (including legal structure, financial data on related transaction parties, etc.), description of intra-group transactions (including in relation to transaction volume, comparability factors, etc.), comparability analysis, etc. Accordingly, Danish MNE group members are indeed familiar with the documentation burden, not least considering that transfer pricing documentation has played a highly important role in defending transfer pricing positions in Denmark due to the formalistic approach of the Danish tax authorities.

Transfer pricing documentation prepared pursuant to the Danish pre-BEPS regulations can, to a large extent, be rearranged to fit the BEPS standard and structure, i.e., division of the report into a master file and a local (Danish) file. However, the BEPS documentation standard (applicable as of 1 January 2016) outlines items that were not required under the former regulations, such as the supply chain and the main drivers of business profit descriptions as part of the master file. The BEPS standard therefore indisputably adds to the burden of transfer pricing documentation in Denmark.

Implementing the BEPS documentation standard, the scope of the descriptions, analyses, etc. depends on the scope and complexity of the group, the Danish taxpayer, and the transactions. Accordingly, in relation to the supply chain description, for example, certain taxpayers may only need to include a high-level description, while others may be required to prepare descriptions that are more detailed. Certain taxpayers may feel the necessity to prepare a detailed value chain analysis to demonstrate that profit allocations adhere to Actions 8-10, and the inclusion of such analysis will surely mean a significant increase in the documentation burden, including the costs attributable documentation. Value and supply chain analyses have not been commonly used in Denmark pre-BEPS, but the Danish tax authorities have previously argued that a TNMM or similar one-sided approach is insufficient when the full chain of supply is not disclosed, though such disclosure was not a required item under the pre-BEPS regulations.

4. How might the focus of domestic transfer pricing disputes change – for example, might they tend to be resolved more by reference to global value chain analyses, where risk decisions are taken or the commercial rationality of arrangements?

Focus will be on substance and actual functions rather than contractual arrangements and legal formalities. In line with recent years' tendencies, there will likely be an increase in the challenge of intra-group contracts as the basis for determining the nature of transaction (delineation test) in light of BEPS giving clear priority to actual conduct (substance) over the contents of written agreement. Surely, contracts will remain important in transfer pricing cases, maybe even more so following BEPS, considering that copies of material agreements must be filed as part of the transfer pricing documentation under the new standard, as mentioned above. The tax authorities will likely expect that taxpayers are able to demonstrate that the applicable contracts governing the transactions are not misaligned with the parties' conduct.

5. Is your jurisdiction signing the MLI? How might the resolution of MAP matters involving your jurisdiction change?

Pursuant to a recent political agreement on measures to combat international tax avoidance, the Danish government has declared its intention to sign the Multilateral Instrument developed under Action 15 for the implementation of the BEPS tax treaty items in June 2017. The Parliament has passed a series of measures over the recent years aimed at combatting international tax avoidance and this agreement represents the latest measure.

Changes in the resolution of MAP cases is expected not only because of the BEPS measures, but also as a result of initiatives at the EU level. Following BEPS and the expected intensified scrutiny of cross-border profit allocation, an increase in MAP filings is indeed expected as well. Certainly, there is room for significant improvement of the MAP mechanism provided for in applicable Danish tax treaties in order for the procedure to become an effective instrument for the resolution of transfer pricing disputes. In particular, professional and industrial bodies have called upon the inclusion of mandatory binding MAP arbitration in Danish tax treaties. The Danish government has been hesitant on this item and Denmark has accordingly not declared its commitment to provide for binding MAP arbitration in Danish tax treaties pursuant to the BEPS Action 14 initiative. The minimum standard developed under Action 14 may improve the MAP dispute resolution mechanism on certain points, in particular in relation to resolving disputes within a reasonable timeframe. It does, however, seem unlikely that the minimum standard and best practices will be sufficient to counterbalance the expected increase in disputes in the wake of BEPS, though an increase in the number of MAP filings could necessitate and thus result in the implementation of procedures that are more expedient and effective.

MAP dispute resolution under the EU Arbitration Convention (Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises) is generally more efficient than tax treaty MAP dispute resolution, as the Arbitration Convention provides for arbitration in the event that the member states are not able to resolve the dispute under MAP proceedings within a two-year timeframe. The Arbitration Convention, however, also falls short on a number of points, including the lack of enforceability (other than through domestic courts) and differences in interpretation and application. If the proposed EU directive on dispute resolutions mechanisms (Council Directive on Double Taxation Dispute Resolution Mechanisms of October 25, 2016) is adopted, there will likely be a significant improvement of the efficiency of transfer pricing MAP dispute resolution within the EU. The draft directive builds on the principles outlined in the Arbitration Convention, but the rules laid down in the draft directive are more firm (though clarification would be ap-

propriate on certain items) and differ from the Convention in a variety of fields.

According to the draft directive, EU member states shall implement the directive into their domestic laws by December 31, 2017. However, negotiations are still pending. The Danish government has declared its willingness to discuss expanded arbitration procedures openly in relation to the draft directive, though the government has also raised some concerns.

6. Could there be more or less interest in APAs in your jurisdiction?

In response to increased exposure and uncertainties attributable to the BEPS measures, there could be an increase in APA applications. In practice, however, APAs will likely still be reserved to larger MNE groups due to the costs and resources involved and this will presumably not change any time soon.

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