Grant Thornton

Japan Tax Bulletin

The 2022 edition of the OECD Tranfer Pricing Guidelines

July 2022

On 20 January 2022, the OECD released the 2022 edition of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("2022 edition").

The OECD Transfer Pricing Guidelines provide guidance on the application of the "arm's length principle", which represents the international consensus on the valuation, for income tax purposes, of cross-border transactions between associated enterprises. In today's economy where multinational enterprises play an increasingly prominent role, transfer pricing continues to be high on the agenda of tax administrations and taxpayers alike. Governments need to ensure that the taxable profits of MNEs are not artificially shifted out of their jurisdiction and that the tax base reported by MNEs in their country reflects the economic activity undertaken therein. Meanwhile taxpayers need clear guidance on the proper application of the arm's length principle.

Transition from the past

After issuing Transfer Pricing Guidelines for Multinational Enterprises, Report of the OECD Committee on Fiscal Affairs1979, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, Report of The OECD Committee on Fiscal Affairs 1995 was released. In 2009, the 2009 update edition was released mainly to reflect the adoption of the arbitration clause in the 2008 update of the Model Tax Convention. In the 2010 edition, Chapter I -III of the Transfer Pricing Guideline were substantially revised, with new guidance on the selection of the most appropriate transfer pricing method to the circumstances of the case, the practical application of transactional profit methods (the transactional net margin method and the profit split method) and the performance of comparability analyses. In addition, the 2010 version of the Transfer Pricing Guidelines contains a new Chapter IX on the transfer pricing aspects of business restructurings. The 2017 edition of the OECD Transfer Pricing Guidelines incorporated substantial revisions to reflect clarifications and revisions contained in the 2015 BEPS Reports on Actions 8-10 (Aligning Transfer Pricing Outcomes with Value Creation) and Action 13 (Transfer Pricing Documentation and Country-by-Country Reporting).

Changes in the 2022 edition

Based on the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, the 2022 edition also consolidates into a single publication the changes to the 2017 edition of the Transfer Pricing Guidelines resulting from:

The report Revised Guidance on the Transactional Profit Split Method, approved by the OECD/G20 Inclusive Framework on BEPS on 4 June 2018, and which replaced the guidance in Chapter II, Section C (paragraphs 2.114-2.151) found in the 2017 Transfer Pricing Guidelines and Annexes II and III to Chapter II;

The report Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles, approved by the OECD/G20 Inclusive Framework on BEPS on 4 June 2018, which has been incorporated as Annex II to Chapter VI;

The report Transfer Pricing Guidance on Financial Transactions, adopted by the OECD/G20 Inclusive Framework on BEPS on 20 January 2020, which has been incorporated into Chapter I (new Section D.1.2.2) and in a new Chapter X;

The consistency changes to the rest of the OECD Transfer Pricing Guidelines needed to produce the 2022 edition which were approved by the OECD/G20 Inclusive Framework on BEPS on 7 January 2022.

Newly incorporated guidance in the 2022 edition

1	Revised Guidance on the Transactional Profit Split Method (TPSM Guidance)
2	Guidance for Tax Administrations on the Approach to Hard-to-Value Intangibles (HTVI Guidance)
3	Transfer Pricing Guidance on Financial Transactions (FT Guidance)

Revised guidance on transactional profit split method (TPSM Guidance)

First, compared to other transfer pricing methods, the following cases are presented as cases in which the Transaction Profit Split Method may be the most appropriate transfer pricing method in the TPSM Guidance.

ⅰ) Each party makes a unique and valuable contribution

ⅱ) Transactions covered are highly integrated and the contribution of each party cannot be evaluated in isolation from the other parties

ⅲ) The parties jointly bear economically significant risks or bear closely related risks separately

The TPSM Guidance also includes several examples introducing the principles discussed. In terms of relevant profits to be split, the TPSM Guidance clarifies that it is necessary to accurately identify the income and expenses associated with the covered transactions separately from other transactions, and to calculate the profit subject to division by adjusting for differences in currency, accounting standards, and other factors.

Regarding profit splitting factors, the TPSM Guidance clarifies that split factors should reflect the relative contributions of the parties involved in the transactions. In addition to assets, capital, and expenses, the number of personnel involved in the transactions and the number of hours worked may also be appropriate as split factors if they are strongly correlated with profit generation, as indicators that can reliably measure relative contribution.

Guidance for tax administrations on Hard-to-Value Intangibles (HTVI Guidance)

The HTVI Guidance was developed to deal with information asymmetry available between taxpayers and tax administrations in terms of HTVI potential values when it is transferred between foreign related parties. The HTVI approach allows tax authorities to use post evidences on the financial outcomes caused by HTVI transactions as presumptive evidences about the appropriateness of prior pricing arrangements. It also aims to reach common understanding and practice about how taxpayers and tax administrations apply for HTVI. The HTVI Guidance is intended to improve the coherence and decrease the risk of economic double taxation when the HTVI Guidance is applied.

Transfer pricing guidance on financial transactions (FT Guideline)

Transfer pricing rules for financial transactions remained largely absent of any guidance or rules to which reference could be made until the FT Guideline was issued in 2020.

With the official addition of the FT Guidance to the Transfer Pricing Guidelines in 2020, countries, including Japan, that do not yet have domestic laws in place regarding transfer pricing for financial transactions will be forced to take certain actions. The FT Guidance is provided on determining the arm's length conditions for treasury activities such as intra group loans, cash pooling, hedging, and financial guarantees and captive insurance.

Implications

The 2022 edition consolidates the changes and revisions that have been incorporated since the release of 2017 edition of OECD Transfer Pricing Guidelines. Each country takes different process with respect to whether and how tax authorities incorporate the 2022 edition into their domestic transfer pricing tax rules. For instance, the domestic tax rules clearly follows the approved OECD Transfer Pricing Guidelines in some countries, therefore their updates have been almost automatically reflected, meanwhile governments need some form of administrative or other procedures to contain a new version of the Transfer Pricing Guidelines into their domestic laws in other countries. In general, these new transfer price rule adjustments simply replace the current OECD Guidelines with the previous ones.

Each local tax authorities, however, may use this opportunity as a chance to contemplate local legislation and guidelines. Hence, multinational enterprises need to be on the alert about any changes in domestic transfer pricing rules. Each local tax authorities also probably aim to utilize the 2022 edition of OECD Guidelines to reinforce their transfer price tax investigation position especially on integrated value chains, unique intangible property, and financial transactions. The number of transfer price tax investigation might be increased by tax authorities in both OECD member nations and non-OECD ones, taking advantage of the application of the concepts reflected in this revisions.

Multinational enterprises need to recognize analyze the implications of this transfer pricing rule change in each tax authority in which they have been conducting businesses. They also need to analyze its impact of the transfer pricing rule change. In other words, multinational enterprises should consider their transfer pricing policies, taking their global business operations and their current transfer pricing policies into consideration in line with the introduction of 2022 edition.