Editorial

For many international tax professionals, the transfer pricing issue today is not so much linked with sinister multinationals shifting profits at will all over the world, but rather with governments fiercefully competing for their 'piece of the cake'. Of course, there are the tax treaties, providing that if transactions between associated enterprises have taken place on an arm's length basis they have to be accepted by the authorities (Commentary on article 9, 1977 OECD Model Treaty), but it is probably not a secret that this arm's length principle leaves some room for discussion in the actual circumstances of any case. It was therefore applauded that the tax authorities of the OECD countries (The Committe on Fiscal Affairs) published a Report on the issue in 1979. It is true that on some points the authorities agreed to disagree, or limit, themselves to a mere pondering of many 'ifs and buts', but, by and large, the Report was considered as providing at least some guidance. Some countries even went so far as to adopt parts of the Report in their national guidelines. A subsequent Report issued in 1984 discussed in somewhat more depth especially the allocation of central management and service costs and was certainly not an improvement. At many points the 1984 Report showed a complete disagreement among the tax authorities on basic issues.

However, even on the points where, at least in the Reports, there seemed to be agreement, it became quickly clear that, in reality, this was not the case. Take the example of charges for intergroup services. Both OECD Reports accept these charges if 'a real benefit has been conferred on an enterprise' and both provide some guidance with regard to the application of this benefit test. The 1979 Report, furthermore, accepted the principle that the charges include a profit element, even if the charges are based on a cost allocation system. The 1984 Report considers them sometimes 'appropriate' although one (unmentioned) country does not 'require' them.

Now what is the current attitude of the tax authorities in two of the major industrial nations – Germany and the United States – twoards these guidelines?

The German tax authorities, with a typical national sense of perfection, were not happy at all with the Reports. They decided therefore to do it much better and issued in 1983 detailed 'Administrative Principles' (Verwaltungsgrundsätze). These principles are, at some points, in clear conflict with the OECD Reports. With regard to the charges based on a cost allocation agreement, they do, for instance, not allow a profit element, since there would be no 'entrepreneurial risk' involved (Principles, paragraph 7.1.6). The US transfer pricing regulations under IRC Sect. 482 are more flexible with regard to a possible profit mark-up. The IRS, however, challenges the validity of the guidelines in the OECD Reports with respect to the benefit test (Regs. paragraph 1.482-2 (b) (2)). In a recent ruling (LTR 8806002) the Service notices that, although it considers the Reports as 'helpful', they nevertheless could not 'be accepted as a reasonable interpretation of the benefit test'.

One may start wondering what the purpose is of all these reports other than being 'discussion documents, which point out the problem of taxation that exists due to the differences in the systems of taxation from country to country' (LTR 8806002).

In this context it should be remembered that, in most countries, transfer pricing regulations do not have statutory status, but are mereley administrative guidelines. One would, therefore, expect that, within the framework of the OECD, the tax authorities involved should be able to negotiate a reasonable solution for these 'problems' and adjust their national guidelines accordingly.

In contrast, but perhaps not surprisingly, much more progress was made in the area of 'mutual administrative assistance', where a far reaching multilateral convention has now been drafted. You will find in this issue an excellent review of the Convention by Mr. Daniels. There is, of course, no doubt that the increasing information flow based on the Convention will result in even more 'problems' in the transfer pricing area. As Mr. Sass points out in his article, the Convention will make the solutions for these problems all the more urgent. Since is seems to be impossible to agree on common principles in bodies like the OECD, the EC-Commission has proposed plans to introduce an arbitration procedure, which – within a certain time frame – guarantees the elimination of double taxation.

One would hope that this arbitration procedure – the Fiscal Committee of the OECD in its

1984 Report saw no need for such a procedure – may be adopted by the EC Member States as the logical consequence of the administrative assistance Convention.

In this issue you will also find an excellent article by Mr. William P. Streng on US International Estate Planning; an interesting subject on which little has been published. For the 'affectionados' of indirect taxes there is an instructive article by Mr. Correia and Mrs. Lopes on the introduction of the Value Added Tax in Portugal.

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