

Transfer pricing bulletin

Life after DSG?

In the wake of the Special Commissioners ruling in *DSG Retail Ltd vs HMRC* (2009 TC00001) meticulous analysis of inter-company legal and contractual relationships is now more important than ever.

Over the past few months we have increasingly seen tax authorities in the UK, US and across Europe questioning apparently watertight attribution of risks and functions in the pricing models of group transactions. Previously companies have relied on written contractual terms and conditions of those inter-company transactions without carefully comparing them with the actual day-to-day behaviour of the parties involved. This is particularly of note in a period where significant changes to external market conditions may affect the commercial practices of a business: inter-company agreements often remain undisturbed for lengthy periods, and may therefore not adequately reflect the routine operational changes that have inevitably taken place in the interim. Not only does this increase the risk that out-dated inter-company agreements may have been used as a detailed template for determining terms and conditions for comparable uncontrolled prices, but also that the use of any given transfer pricing method is fundamentally flawed.

Whilst the technical scrutiny of companies' transfer pricing methods and the associated documentation is becoming ever more detailed, it does create opportunities. The emphasis on the connection between tangible changes in operational and legal structuring and the effect on tax and transfer pricing can be exploited, whether this relates to goods, services or intangibles. Demonstrable business change can often allow a re-assessment of the transfer pricing of a group as a whole, where previously tax authorities may have queried changes in inter-company pricing policy as being merely an exercise in 'form over substance' and not representative of a genuine change in operational relationships. With the OECD discussion paper on the Transfer Pricing Aspects of Business Restructurings providing a useful analytical basis for identification of potentially contentious areas, we now also have a clearer framework for the transfer pricing consequences of often complex operational changes.

Without detailed technical analysis of the functions and risks inherent in group transactions and the legal documentation supporting them, we have seen that potential tax penalties can be savage. As evidenced by

billion dollar settlements being paid to the IRS, correlation between inter-company contractual relationships and the transfer pricing adopted is absolutely critical. Therefore, as long as collars and cuffs match, a welcome result from a period of commercial uncertainty and change can be an inter-company pricing structure that is both tax-efficient and defensible from every standpoint.

Transfer Pricing News Snapshot

- Taxpayer wins first major skirmish in the ongoing war on cost-sharing buy-in payments - in *Veritas Software Corp. v Commissioner*, (133 T.C. No. 14, 10 December 2009) the US Tax Court dismisses IRS's \$1.675 billion income adjustment as 'arbitrary, capricious and unreasonable'.
- Hong Kong issues Departmental Interpretation Practice Note 46 in December 2009, its first commentary outlining key transfer pricing guidelines for the jurisdiction, but this leaves room for doubt over the documentation process that needs to be adopted in practice.
- The Tax Court of Canada decision in *General Electric Capital Canada Inc. v The Queen* (2009 TCC563, 4 December 2009) provides comfort for taxpayers that in principle inter-company guarantee fees are deductible for tax purposes. However in citing certain qualitative business factors that were critical to the determination of an 'arms-length' price, this long-awaited ruling has thrown up some fundamental issues that are likely to impact on similarly structured transactions.

CMS has extensive international expertise in advising multinationals on transfer pricing and other integrated services. For further information on these or any other issues please contact:



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