Glossary

Advance pricing arrangement (APA)

An arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. An advance pricing arrangement may be unilateral involving one tax administration and a taxpayer or multilateral involving the agreement of two or more tax administrations.

Arm’s length principle

The international standard that OECD member countries have agreed should be used for determining transfer prices for tax purposes. It is set forth in Article 9 of the OECD Model Tax Convention as follows: where “conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly”.

Arm’s length range

A range of figures that are acceptable for establishing whether the conditions of a controlled transaction are arm’s length and that are derived either from applying the same transfer pricing method to multiple comparable data or from applying different transfer pricing methods.

Associated enterprises

Two enterprises are associated enterprises with respect to each other if one of the enterprises meets the conditions of Article 9, sub-paragraphs 1a) or 1b) of the OECD Model Tax Convention with respect to the other enterprise.

Balancing payment

A payment, normally from one or more participants to another, to adjust participants' proportionate shares of contributions, that increases the value of the contributions of the payer and decreases the value of the contributions of the payee by the amount of the payment.

Buy-in payment

A payment made by a new entrant to an already active CCA for obtaining an interest in any results of prior CCA activity.

Buy-out payment

Compensation that a participant who withdraws from an already active CCA may receive from the remaining participants for an effective transfer of its interests in the results of past CCA activities.

Comparability analysis

A comparison of a controlled transaction with an uncontrolled transaction or transactions. Controlled and uncontrolled transactions are comparable if none of the differences between the transactions could materially affect the factor being examined in the methodology (e.g. price or margin), or if reasonably accurate adjustments can be made to eliminate the material effects of any such differences.

Comparable uncontrolled transaction

A comparable uncontrolled transaction is a transaction between two independent parties that is comparable to the controlled transaction under examination. It can be either a comparable transaction between one party to the controlled transaction and an independent party ("internal comparable") or between two independent parties, neither of which is a party to the controlled transaction ("external comparable").

Comparable uncontrolled price (CUP) method

A transfer pricing method that compares the price for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.

Compensating adjustment

An adjustment in which the taxpayer reports a transfer price for tax purposes that is, in the taxpayer's opinion, an arm's length price for a controlled transaction, even though this price differs from the amount actually charged between the associated enterprises. This adjustment would be made before the tax return is filed.

Contribution analysis

An analysis used in the profit split method under which the relevant profits from controlled transactions are divided between the associated enterprises based upon the relative value of the contributions made by each of the associated enterprises participating in those transactions, supplemented where possible by external market data that indicate how independent enterprises would have divided profits in similar circumstances.

Controlled transactions

Transactions between two enterprises that are associated enterprises with respect to each other.

Corresponding adjustment

An adjustment to the tax liability of the associated enterprise in a second tax jurisdiction made by the tax administration of that jurisdiction, corresponding to a primary adjustment made by the tax administration in a first tax jurisdiction, so that the allocation of profits by the two jurisdictions is consistent.

Cost contribution arrangement (CCA)

A CCA is a contractual arrangement among business enterprises to share the contributions and risks involved in the joint development, production or the obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangible assets or services are expected to create benefits for the individual businesses of each of the participants.

Cost plus mark-up

A mark-up that is measured by reference to margins computed after the direct and indirect costs incurred by a supplier of property or services in a transaction.

Cost plus method

A transfer pricing method using the costs incurred by the supplier of property (or services) in a controlled transaction. An appropriate cost plus mark-up is added to this cost, to make an appropriate profit in light of the functions performed (taking into account assets used and risks assumed) and the market conditions. What is arrived at after adding the cost plus mark up to the above costs may be regarded as an arm’s length price of the original controlled transaction.

Direct-charge method

A method of charging directly for specific intra-group services on a clearly identified basis.

Direct costs

Costs that are incurred specifically for producing a product or rendering service, such as the cost of raw materials.

Functional analysis

The analysis aimed at identifying the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions.

Global formulary apportionment

An approach to allocate the global profits of an MNE group on a consolidated basis among the associated enterprises in different jurisdictions on the basis of a predetermined formula.

Gross profits

The gross profits from a business transaction are the amount computed by deducting from the gross receipts of the transaction the allocable purchases or production costs of sales, with due adjustment for increases or decreases in inventory or stock-in-trade, but without taking account of other expenses.

Independent enterprises

Two enterprises are independent enterprises with respect to each other if they are not associated enterprises with respect to each other.

Indirect-charge method

A method of charging for intra-group services based upon cost allocation and apportionment methods.

Indirect costs

Costs of producing a product or service which, although closely related to the production process, may be common to several products or services (for example, the costs of a repair department that services equipment used to produce different products).

Intra-group service

An activity (e.g. administrative, technical, financial, commercial, etc.) for which an independent enterprise would have been willing to pay or perform for itself.

Intentional set-off

A benefit provided by one associated enterprise to another associated enterprise within the group that is deliberately balanced to some degree by different benefits received from that enterprise in return.

Marketing intangible

An intangible (within the meaning of paragraph 6.6) that relates to marketing activities, aids in the commercial exploitation of a product or service and/or has an important promotional value for the product concerned. Depending on the context, marketing intangibles may include, for example, trademarks, trade names, customer lists, customer relationships, and proprietary market and customer data that is used or aids in marketing and selling goods or services to customers.

Multinational enterprise group (MNE group)

A group of associated companies with business establishments in two or more jurisdictions.

Multinational enterprise (MNE)

A company that is part of an MNE group.

Mutual agreement procedure

A means through which tax administrations consult to resolve disputes regarding the application of double tax conventions. This procedure, described and authorised by Article 25 of the OECD Model Tax Convention, can be used to eliminate double taxation that could arise from a transfer pricing adjustment.

Net profit indicator

The ratio of net profit to an appropriate base (e.g. costs, sales, assets). The transactional net margin method relies on a comparison of an appropriate net profit indicator for the controlled transaction with the same net profit indicator in comparable uncontrolled transactions.

"On call" services

Services provided by a parent company or a group service centre, which are available at any time for members of an MNE group.

Primary adjustment

An adjustment that a tax administration in a first jurisdiction makes to a company's taxable profits as a result of applying the arm's length principle to transactions involving an associated enterprise in a second tax jurisdiction.

Profit potential

The expected future profits. In some cases it may encompass losses. The notion of "profit potential" is often used for valuation purposes, in the determination of an arm's length compensation for a transfer of intangibles or of an ongoing concern, or in the determination of an arm's length indemnification for the termination or substantial renegotiation of existing arrangements, once it is found that such compensation or indemnification would have taken place between independent parties in comparable circumstances.

Profit split method

A transactional profit split method that identifies the relevant profits to be split for the associated enterprises from a controlled transaction (or controlled transactions that it is appropriate to aggregate under the principles of Chapter III) and then splits those profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been agreed at arm's length.

Resale price margin

A margin representing the amount out of which a reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit.

Resale price method

A transfer pricing method based on the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. The resale price is reduced by the resale price margin. What is left after subtracting the resale price margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. custom duties), as an arm's length price of the original transfer of property between the associated enterprises.

Residual analysis

An analysis used in the profit split method which divides the relevant profits from the controlled transactions under examination into two categories. In the first category are profits attributable to contributions which can be reliably benchmarked: typically less complex contributions for which reliable comparables can be found. Ordinarily this initial remuneration would be determined by applying one of the traditional transaction methods or a transactional net margin method to identify the remuneration of comparable transactions between independent enterprises. Thus, it would generally not account for the return that would be generated by a second category of contributions which may be unique and valuable, and/or are attributable to a high level of integration or the shared assumption of economically significant risks. Typically, the allocation of any residual profit (or loss) remaining after allowing for the profits attributable to the first category of contributions would be based on an analysis of the relative value of the second category of contributions by the parties, supplemented where possible by external market data that indicate how independent enterprises would have divided profits in similar circumstances.

Secondary adjustment

An adjustment that arises from imposing tax on a secondary transaction.

Secondary transaction

A constructive transaction that some jurisdictions will assert under their domestic legislation after having proposed a primary adjustment in order to make the actual allocation of profits consistent with the primary adjustment. Secondary transactions may take the form of constructive dividends, constructive equity contributions, or constructive loans.

Shareholder activity

An activity which is performed by a member of an MNE group (usually the parent company or a regional holding company) solely because of its ownership interest in one or more other group members, i.e. in its capacity as shareholder.

Simultaneous tax examinations

A simultaneous tax examination, as defined in Part A of the OECD Model Agreement for the Undertaking of Simultaneous Tax Examinations, means an "arrangement between two or more parties to examine simultaneously and independently, each on its own territory, the tax affairs of (a) taxpayer(s) in which they have a common or related interest with a view to exchanging any relevant information which they so obtain".

Trade intangible

An intangible other than a marketing intangible.

Traditional transaction methods

The comparable uncontrolled price method, the resale price method, and the cost plus method.

Transactional net margin method

A transactional profit method that examines the net profit margin relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realises from a controlled transaction (or transactions that it is appropriate to aggregate under the principles of Chapter III).

Transactional profit method

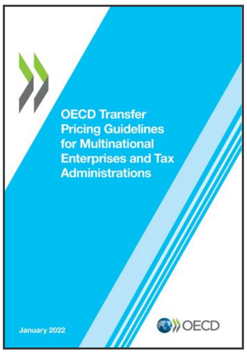
A transfer pricing method that examines the profits that arise from particular controlled transactions of one or more of the associated enterprises participating in those transactions.

Uncontrolled transactions

Transactions between enterprises that are independent enterprises with respect to each other.

Unique and valuable contributions

Contributions (for instance functions performed, or assets used or contributed) will be "unique and valuable" in cases where (i) they are not comparable to contributions made by uncontrolled parties in comparable circumstances, and (ii) they represent a key source of actual or potential economic benefits in the business operations.



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