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Related parties as used in transfer pricing

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Related Parties As Used in Transfer Pricing

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Related Parties As Used in Transfer Pricing

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A Executive Summary

The scope of related party transactions for transfer pricing purposes in the OECD Model Tax Convention (OECD MTC), OECD Transfer Pricing Guidelines (OECD TPG) and the transfer pricing regimes of selected tax jurisdictions were reviewed for differences. The term “associated enterprises” in Associated Enterprises Article (Article 9) of the OECD MTC was intended to apply to parent and subsidiaries, as well as companies under common control. The original objective of Article 9 was to ensure the proper allocation of profits between enterprises that had common ownership of stock or capital. All three elements of participation in capital, management and control have to be present for two enterprises to be considered as associated for the purpose of Article 9. The interconnectedness in Article 9 may be found in company law which governs the relationship between the companies. However, mere interconnectedness is insufficient for the application of the Article, as it must be demonstrated that such interconnectedness leads to an ability to influence the transfer pricing between enterprises for Article 9 to be applied. There has to be management that results in control, and a qualitative assessment is required to determine this.

Domestically, many jurisdictions consider control to be present if there are shareholding relationships, which is a fairly blunt test. How control is be determined in substance presents an even broader range of definitions amongst the jurisdictions surveyed. As tax treaties are meant to restrict the application of domestic tax rules, if a jurisdiction’s domestic legislation imposes profit adjustments on enterprises associated by definition but where there is no control, it is arguable that the jurisdiction is not acting in accordance with Article 9(1) of the treaty and the other contracting state is not obliged to provide double taxation relief under Article 9(2). In addition, it could be said that if a jurisdiction makes adjustments on the transactions between two enterprises which are not associated under the treaty, but associated under domestic law, Article 9 and consequently it may not be clear if the Mutual Agreement Procedure Article (Article 25) under paragraph 1 would be applicable. A possible solution could be for both contracting states to find a solution via Article 25(3) to remove economic double taxation.

There are certain practical implications arising from the differences between the related party definition in Article 9 of the OECD MTC compared to that in domestic transfer pricing legislations. For example, some joint ventures (JVs) may fall within the domestic definitions of related party transactions. However, based on the original intention and scope of Article 9(1), JVs should not be caught within the scope of associated enterprises. There are also ambiguities when it comes to the application of Article 9 and domestic transfer pricing regimes to family owned companies/businesses. Different definitions of related party transactions in domestic transfer pricing legislations could cause practical difficulties in assessing comparability in a transfer pricing analysis. In addition, where proxies are used to identify associated

enterprises/related parties, such as in the case of country-by-country reporting, entities that may not be considered as associated to each other for the OECD or domestic tax purposes could be disclosed, which could lead to unnecessary complications and compliance costs to taxpayers. Finally, the "closely related" concept proposed under BEPS Action 7 could arguably bring in new factors for consideration in determining relatedness, as jurisdictions consider how to define the scope of related parties in their transfer pricing regimes.

Therefore, there is a need to provide more clarity on the meaning of the term "associated enterprise" in Article 9, as it serves the objective of the elimination of economic double taxation and ensures that transactions between associated enterprises are conducted at arm's length. Where economic double taxation results, it also provides the mechanism for the other jurisdiction to make adjustments and remove the economic double taxation. Domestic TP legislation has a broader purpose, which is to ensure arm's length behaviour in both a domestic and cross border context. Every jurisdiction can exercise its sovereign right to set its own rules to meet its specific objectives. In a cross border context, the real issue would tend to arise in the context of parents and subsidiaries or subsidiaries in the same group, and less so of other types of association, e.g. by blood relations. While the domestic and international definitions of associated enterprises are not aligned, what matters is that countries interpret Article 9 and their obligation with consensus to ensure that the intended effect of the Article is achieved.

Given the increasing focus on transfer pricing, more transfer pricing disputes are expected and correspondingly a greater use of Article 9 to eliminate economic double taxation. This intensifies the need for clarity on the scope of Article 9. It may also be timely to review the scope in light of the changes that are being made to the OECD TPG.

B Paper

1. Introduction

The proposed research examines the scope of what are considered as related party transactions falling under the OECD TPG as well as the transfer pricing regimes of selected tax jurisdictions.

Most jurisdictions define related party transactions for transfer pricing purposes using the concept of "control", but countries perceive "control" from various and sometimes vastly different perspectives. Some jurisdictions' definitions of related party transactions have been conceptualized specifically for the purposes of their transfer pricing regimes, while others may have adopted the definitions used for other income tax or even non-tax purposes.

The OECD TPG does not deal with the concept of Associated Enterprises as used in Article 9 of the OECD MTC. Article 9 of the OECD MTC does not define the terms that are used in the definition of associated enterprises. This gives rise to the question of what exactly was intended for under the scope of Article 9 and its consequent applicability.

The paper starts with an attempt to define the term “Associated Enterprises” and the scope of Article 9 of the OECD MTC. It then seeks to ascertain the various models used to define the scope of related party transactions in transfer pricing regimes and discuss the extent of such variation and its implications, including the impact on taxpayers. The high level implications of the differences between the international meaning and domestic meaning of “Associated Enterprises/related parties” are then discussed. The paper then discusses the practical implications arising from such differences in certain specific scenarios i.e. joint ventures, family owned companies, comparability and country-by-country reporting. The implications of the “closely related” concept proposed under BEPS Action 7 are also discussed. Finally, the paper concludes with some recommendations to resolve these issues.

2. Transfer Pricing

2.1. OECD Model Tax Convention

Cross border trades and transactions has grown tremendously over the years. This is facilitated by the opening up of country borders and advent in technology. It becomes important that there is an international system to allocate profits across the jurisdictions where the activities take place in. This helps to prevent double taxation which impedes the exchange of goods and services, capital, technology and persons.[1] Guidance or clear rules on the allocation of international profits also help to prevent disputes between jurisdictions arising from the allocation of profits.

The OECD introduced the MTC to harmonize and standardize rules for profit allocation and to prevent double taxation. The League of Nations commenced its work in 1921. This led to the first model bilateral convention in 1928 (1928 draft model), the Mexico model in 1943 and the London model in 1946. These models were not accepted by all jurisdictions.[2] However, bilateral tax conventions were already entered into by jurisdictions to resolve double taxation conflicts between themselves. Post World War II, the importance of extending bilateral tax conventions to more countries and the need for harmonization among these conventions was recognised. Further work was started in 1956 to establish a model tax convention that would be acceptable to most jurisdictions. This resulted in the 1963 model which was adopted by the council

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1 Introduction to the OECD Model Tax Convention 2014.

2 The term “jurisdictions” and “states” is used interchangeably in this paper.

of OECD. This model has been updated on a continuous basis to adapt it to changing economic conditions and the new ways in which cross border transactions were undertaken.[3] This is the OECD MTC as we know it today.

2.2. Associated enterprises

In the first League of Nations draft of 1927, subsidiary companies were treated as permanent establishments (PEs) of their parent company. The term “affiliated companies” was used.[4] Consequently, there was no need for the equivalent of Article 9 of the OECD MTC as we know it today.[5]

Over time, most jurisdictions favoured the treatment of subsidiaries as separate entities. These were then excluded from the PE concept.[6] In the 1928 draft model, subsidiaries were treated as separate entities for tax purposes. The treatment of subsidiaries ran in parallel to PEs. The drafts were only concerned with the portion of profits that could be diverted from a domestic enterprise to an enterprise in the other contracting State.[7] As there was no provision relating to the allocation of business income between subsidiaries and parent companies, it was recognised that multinational enterprises (MNEs) were at the risk of double taxation.[8] Today, Article 9 has evolved and applies to the diversion of profits of a domestic enterprise to enterprises in third states.[9]

According to US economist, Thomas S Adams, the problem of allocation of business income is more complex than thought. The prime cases of double taxation resulted from the existence of international business income.[10] A detailed study setting out rules on the allocation of income was needed and US lawyer, Mitchell B Carroll was appointed by the League of Nations to carry out this research.[11] The term

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[3] OECD (2014), ‘Introduction – Historical background’, in *Model Tax Convention on Income and on Capital: Condensed Version 2014*, OECD Publishing.

[4] League of Nations, ‘Taxation of Foreign and National Enterprises – Methods of allocating Taxable Income’, *Volume IV (Geneva: League of Nations Document No. C425(b).M.217(b).1933.II.A.,1933*, at pg 109.

[5] K. Vogel, ‘Article 9 chapter’, *Klaus Vogel on double taxation conventions: a commentary to the OECD-,UN- and US model conventions for the avoidance of double taxation on income and capital with particular reference to German treaty practice*, Kluwer Law International 1997, Third edition 1997, Para 9.

[6] MB Carroll, ‘Two decades of Progress under the League of Nations’, *League of Nations Prevention of Int double taxation and fiscal evasion,* League of Nations 1939, pg. 21 and J. Wittendorf, *Transfer Pricing and Arm’s Length Principle in International Tax Law*, Kluwer L. Intl 2010, at pg. 87.

[7] Vogel, op. cit., Article 9 chapter, Para 9.

[8] Wittendorf, op. cit., at pg. 88.

[9] Vogel, op. cit., Article 9 chapter, Para 9.

[10] M.B. Carroll, Taxation of Foreign and National enterprises, Methods of Allocating Taxable income vol. IV League of Nations 1933.

[11] Wittendorf, op. cit., at pg. 89.

"associated companies" was first introduced by Carroll in his 1933 report (Carroll Report) for convenience purposes. We will discuss the meaning of the term "associated companies" as used by Carroll in section 4.2 of this paper.

2.3. The arm's length principle

The Carroll Report recommended that the primary rule for the allocation of business income should be the separate accounting method. This was the first time Carroll referred to the arm's length principle (ALP) i.e. the ALP is the international standard for the allocation of profits between jurisdictions.[12] However, the ALP by itself was not new. The ALP has its origins in contract law. Parties which may have shared interests would need to arrange an agreement at ALP for it to be equitable and to stand up to legal scrutiny.[13] In common law, the phrase "at arm's length dealing" had no significance. According to some American authors, the notion of arm's length dealing was related to the doctrine of "undue influence" that was developed by the courts of equity.[14] The ALP was also used as an allocation norm in US legislation.[15] It was implemented into the France-US tax treaty in 1932.[16]

Since then, the ALP has been accepted by most jurisdictions worldwide. OECD jurisdictions endorsed the ALP in the OECD MTC and in the 1979 report by the OECD to address transfer pricing and other related tax issues with respect to MNEs.[17] The ALP is also the accepted guiding principle in the UN Model.[18] Jurisdictions incorporate the ALP into bilateral tax treaties and coordinate the operation of the ALP internationally.[19] More recently, the ALP was the focus of further clarification in the OECD and G20 countries' Base Erosion and Profit Shifting Action Plan (BEPS Action Plan), particularly with regard to Actions 8, 9 and 10, although interestingly there was

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12 MB Carroll, 'Taxation of Foreign and National Enterprises', *Methods of Allocating Taxable Income vol. IV*, League of Nations 1933.

13 United Nations, *United Nations Practical Manual on Transfer Pricing for Developing Countries*, United Nations New York 2013, Para 1.4.3.

14 Baker, R and Baker D, "The pricing of goods in International Transactions between Controlled Taxpayers', *10 Tax Executive 2.3.5* (1957-1958), pp 247-248 and R Dwarkasing, *Associated Enterprises A concept Essential for the Application of the Arm's Length Principle and Transfer Pricing*, Wolf Legal Publishers, the Netherlands 2011, at pg 41.

15 US Revenue Act 1928 sec. 45, referred to in the US national report to the League of Nations in 1932. US regulations refer to ALP as the arm's length standard. World Tax Journal 2015 (Vol. 7) No. 3 para The Arm's Length Comparable in Transfer Pricing: A Search for an "Actual" or a "Hypothetical" Transaction".

16 Wittendorf, op. cit., at pg. 32.

17 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, OECD publishing 22 July 2010, Foreword and preface.

18 United Nations, op. cit., Para 1.4.3.

19 World Tax Journal 2015 (Vol. 7) No. 3 para 2 The Arm's Length Comparable in Transfer Pricing: A Search for an "Actual" or a "Hypothetical" Transaction".

mention that should the need arise, there could be special measures introduced that may fall beyond the arm's length principle.[20]

2.4. Transfer Pricing Guidelines

While it is relatively easy to describe the ALP, it is a complex exercise to establish guidelines on the practical application of the ALP.[21] There are also differing interpretations of what the ALP means in practice.[22] The OECD has done continuous work on the ALP and transfer pricing. The first edition of the OECD TPG was issued in 1995. Since then, the TPG has been updated continuously to ensure its relevance.[23] OECD jurisdictions have largely followed the TPG in their domestic transfer pricing regulations.[24] The UN has also issued the United Nations Practical Manual on Transfer Pricing (UN Manual) to provide similar guidance to jurisdictions. However, both sets of issued guidelines are only intended to help tax administrations and MNEs to apply the ALP and generally do not carry legal effect. Transfer pricing regimes are creatures of domestic law. Each jurisdiction would have to come up with their own detailed legislation to implement transfer pricing rules.[25] That said, it is ultimately up to each jurisdiction to adopt an approach that works in its domestic, legal and administrative framework that is consistent with its treaty obligations.[26]

3. Objective of TPG in applying ALP

3.1. International aspects

It would be useful to understand the objectives behind both the OECD TPG and UN Manual in applying the ALP. This would provide a better background to interpret the terms and concepts that are used.

The OECD takes the view that tax administrations should not automatically assume that associated enterprises have sought to manipulate their profits. There could be genuine difficulties to determine accurately a market price in the absence of market forces or when adopting a particular commercial strategy. The OECD cautions against the confusion of transfer pricing consideration with that of tax fraud or tax avoidance. This is so even though transfer pricing policies may be used for such

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20 OECD (2015), Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, Executive Summary, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

21 United Nations, op. cit., Para 1.4.7

22 Ibid. Para 1.4.2 and OECD op. cit., para 1 and United Nations, United Nations Model Double Taxation Convention between Developed and Developing Countries, United Nations New York 2011, Article 9.

23 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, Foreword and preface.

24 United Nations, op. cit., Para 1.3.2.

25 Ibid, Para 1.7.2.

26 Ibid, Para 1.7.4.

purposes. [27] The OECD has also reviewed the OECD MTC continuously in recognition of the fact that tax avoidance and evasion has become more sophisticated and with the globalisation and liberalisation of OECD economies in the 1980s.[28]

The UN takes a similar view as the OECD. From a UN perspective, transfer pricing does not necessarily involve tax avoidance. Setting prices is a normal aspect of an MNEs' operations.[29] Price adjustments to approximate the arm's length transaction, which may arise irrespective of the contractual terms between the entities, should not lead to an implicit assumption of profit manipulation. Tax administrations should also not assume incorrectly that commercial or financial relations between associated enterprises, and the marketplace will always be different and at odds with each other.[30] The UN also recognises that MNEs themselves may have an incentive to set an arm's length price for their intra-group transactions so as to judge the true performance of their underlying entities.[31]

In view of the above, the authors take the view that both the OECD TPG and UN Manual apply the ALP with the main objective of ensuring the appropriate level of profit allocation between associated enterprises. This view is also in line with Vogel's opinion that the application of Article 9 is not conditional on the enterprise wilfully attempting to commit tax avoidance. Article 9 is designed with the intention to eliminate economic double taxation.[32] This can only be achieved if profit allocation is subjected to a single rule that is binding on both contracting states to a treaty.[33]

That said, the authors are conscious that the view above is taken based on OECD and UN materials that were written prior to the start of the BEPS Action Plan. The BEPS Action Plan has, as a primary focus, the need to address tax avoidance effectively[34] and a number of its recommendations have been or are expected to be effected through the OECD TPG.[35] The authors remain of the view that the fundamental objectives of the OECD TPG and UN Manual to apply the ALP for profit allocation purposes will be unchanged. Anti-avoidance issues that are taken up under BEPS are a different issue and should not be confused with this. As succinctly put by Vogel, for Article 9 to work, there can only be a single rule under profit allocation. This should not change even in the face of BEPS.

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27 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, at Chp 1 para 1.2.
28 OECD, op. cit., Introduction para 8.
29 United Nations, op. cit., Para 1.1.7.
30 Ibid, Para 1.4.10.
31 Ibid, Para 1.4.11.
32 Vogel, op. cit., Article 9 chapter, Para 7.
33 Vogel, op. cit., Article 9 chapter, Para 17
34 OECD (2015), Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project, OECD.
35 OECD, 'OECD Council approves incorporation of BEPS amendments into the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 15 June 2016.

3.2. Domestic aspect

Moving from the international front to the domestic front, the authors note that jurisdictions may have different objectives when setting up their domestic transfer pricing legislation to apply the ALP. While these jurisdictions may have used the OECD TPG and/ or UN Manual as guidance, their objective of setting up the legislation may go beyond that of mere profit allocation. Often, the objective of addressing tax avoidance may be apparent or even overtake the original objective of profit allocation.

The UN has observed that some developed jurisdictions have tightened their transfer pricing legislation to address the issue of foreign enterprises that are active in their countries but paying lower taxes than comparable domestic groups. Some developing jurisdictions have introduced equally exhaustive transfer pricing regulations in their countries to keep their tax bases intact. Other developing jurisdictions are also recognising the need to address the challenges arising from transfer pricing.[36]

4. Parties to which transfer pricing is applied

4.1. Concept

Conceptually, transfer pricing rules are concerned with determining whether the terms and conditions of a transaction (including the transaction itself) between enterprises belonging to the same group are in line with a specific standard (most often, the arm's length principle). When defining the subjective scope of these rules (i.e. "enterprises belonging to the same group"), the notions of "related parties" or "associated enterprise" are often used. The former notion (i.e. "related parties") is often used in domestic legislation; however, it cannot be found in the OECD/UN MTC or in the OECD TPG and UN Manual. The latter notion (i.e. "associated enterprise"), instead, is the one used by the OECD/UN MTC and in the OECD TPG and UN Manual.

4.2. Associated enterprises

In the OECD MTC and TPG, the term "associated enterprises" is used. The OECD TPG defines the term as follows:

[36] United Nations, op. cit., Para 1.3.2.

"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." [37]

Article 9 of the OECD MTC is as follows:

"

1. Where:
   a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or
   b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State…"

In the commentary to OECD MTC Article 9, with respect to the term "associated enterprises", there was only a reference in parenthesis (bracket definition) to parent and subsidiary companies and companies under common control. There was no other elaboration.[38] In the UN Transfer pricing manual, it was mentioned that Article 9 of the UN MTC applies to intra-group transactions and their acceptability for taxation purpose.[39]

As mentioned under section 2.2, the term "associated companies" was first introduced by Carroll in his 1933 report for convenience. Prior to that, the term "affiliated companies" was used in the League of Nations reports. The term was used in the context of local subsidiary and parent company or other subsidiary companies of the parent. [40] Carrol considered the concept of associated enterprises to be a concept based on company law; subsidiary companies that are controlled through ownership of stock in a local company.

The terms "enterprise of a contracting state" is defined in Article 3 of the OECD MTC. In summary, enterprise of a contracting state simply means an enterprise carried on by a resident of a contracting state. This is so irrespective of the legal form that the enterprise takes.[41] Given the limited guidance available on the definition of "associated enterprises", many scholars have mooted different interpretations of the exact definition of "associated enterprises". Views are divided as to whether there is a

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37 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations,* Glossary.

38 OECD, op. cit., Commentary to Article 9 para 1.

39 United Nations, op. cit., Para 1.4.4.

40 League of Nations, op. cit., at pg 109.

41 Dwarkasing, op. cit., at pg 122.

treaty meaning for the term “associated enterprises” or if the meaning of this term should be drawn from domestic law in accordance with Article 3(2) of the OECD MTC.

Dwarkasing is of the view that there is an autonomous interpretation of the term “associated enterprises”.[42] He supported his view based on the historical evolution of Article 9. The notions of “control” and “controlled enterprises” originated in the early reports of the League of Nations in the 1920s. It went through different rounds of revisions through the years before culminating in today’s version of Article 9. This showed that there was an intended contextual meaning for the term “associated enterprises” within the OECD MTC.[43] He further referred to reports issued by the OEEC in 1960 and by the OECD in 1979 which suggests that there was a broad understanding of the terms “associated enterprises” and “under common control” i.e. there is no need for further clarification.[44]

Hamaekers expressed the opinion that the explanation provided in the commentary to OECD MTC Article 9 cannot be a proper definition. Given that the terms “Participation in management, control or capital” are not defined, Article 3(2) of the OECD MTC is triggered. This means that one would need to refer to domestic tax laws to interpret the meaning of “associated enterprises” and determine whether these meanings make sense in the context of tax treaties and the OECD model.[45]

Applying the general rule of interpretation based on Article 31 of the Vienna Convention on the Law of Treaties, we would argue that the term “associated enterprises” be read in its context and in light of its object and purpose. As such, it should be given a treaty meaning. For the term to enable the article to achieve its objective, there should be a broad basis of understanding for the term. Article 9(1) gives a jurisdiction the right to make upward adjustments to the profits of an enterprise in its jurisdiction if the profits have accrued under conditions that are not at arm’s length. Article 9(2) provides for the other jurisdiction to make downward adjustments on the amount of profits that were brought to tax under Article 9(1). This helps to eliminate double taxation. In a way, the mechanics is similar to the interaction of the distributive articles e.g. Articles 7 and 23 to avoid juridical double taxation.[46] The jurisdiction applying Article 9(2) would have to agree to the adjustment made in Article 9(1) before giving the corresponding relief. Article 9(2) is concerned about the amount of adjustment that should be given. By extension, logically, the jurisdiction giving the relief should also agree to the scope to which Article 9(1) has been applied. Unlike the interaction between the distributive articles and Article 23 where there is a rule to resolve conflicts in qualification, there is no rule that the jurisdiction which applies

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[42] Ibid., at pg. 263.

[43] Ibid., at Chp 5.

[44] OEEC, (Paris 25 May 1960) FC(60)157; OECD Committee on Fiscal Affairs, Report of the OECD Committee on Fiscal Affairs on Transfer Pricing and Multinational Enterprises (Paris: OECD, 1979), FC(60), annex E, at pg. 22, para 2.

[45] Hamaekers, H. “introduction to Transfer pricing”, *Tax treatment of transfer pricing*, Amsterdam IBFD Transfer Pricing database and loose-leaf publication 2008.

[46] Vogel, op. cit., at pg. 518.

Article 9(2) would have to go by the scope to which the other jurisdiction had applied Article 9(1).[47] The commentary to Article 9(2) only says that the jurisdiction applying Article 9(2) is committed to making the adjustment only if it considers that the adjustment made by the other jurisdiction is justified both in principle and as regards the amount.[48] Consequently, this would imply that there should be consensus of sorts on the meaning of the term "associated enterprises". In a bilateral context, if there is no such consensus and each jurisdiction were to apply its domestic law meaning to the term "associated enterprises" and make adjustments, this would reduce the effectiveness of Article 9 and result in unrelieved potential economic double taxation. A jurisdiction could take the view that the jurisdiction making the primary adjustment was not acting in accordance with Article 9(1) and refuse to give relief under Article 9(2). Alternatively, a jurisdiction could take the same view but give relief under Article 9(2) to the extent that it believed was reasonable. In both instances, more likely than not, some extent of economic double taxation would remain.

On the basis that there is a treaty meaning to the term "associated enterprises", this section provides a deeper analysis of the specific meaning of the term.

Article 9(1)(a) uses the term "enterprise" and "enterprise of a Contracting State" while Article 9(1)(b) uses the term "persons". All three terms are defined in Article 3 of the OECD MTC. As explained in section 4.2 above, the terms "enterprise" and "enterprise of a Contracting State" simply refer to the carrying on of any business by a person, regardless of the legal form that it takes. While the use of the term "persons" in Article 9(1)(b) might appear to be broader than the term "enterprise of a contracting state" as used in Article 9(1)(a), Article 9(1)(b) is limited by Article 9(1)(a) by the qualification that these "persons" should be the same as that mentioned in Article 9(1)(a). Consequently, these persons should also be carrying on a business.[49] By definition, this seems to suggest that passive common shareholders in enterprises of both contracting states might not be covered under the scope of Article 9. The fact that the OECD uses the term "persons" instead of "person" should not have a significant impact on the scope of the Article. There should be no difference in terms of participation by the same "person" or "persons".[50]

Both Vogel and Dwarkasing support the view that Article 9 only deals with profit adjustment between enterprises., Specifically, Vogel is of the view that direct or indirect participation in the management, control or capital of an enterprise covers only cases of interconnection, or exercise of influence, under <u>company law</u>. Whether there is a case of participation is decided by reference to (domestic) company law. Article 9 then decides on the form or extent of participation that is relevant.[51] Dwarkasing referred to

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47 OECD, op. cit., Commentary to Article 23 para 32.2 and 32.3.
48 Ibid. Commentary to Article 9 Para 6.
49 Dwarkasing, op. cit., at pg. 125, Vogel, op. cit., at pg. 526.
50 Vogel, op. cit., at pg. 526; Dwarkasing, op. cit., at, at pg. 126.
51 Vogel, op. cit., at pg. 523 and 525

the OECD commentary to Article 9 where there was a bracket definition accompanying the term "associated enterprises", he concluded that Article 9 only applies to the enterprises listed in the bracket definition of "associated enterprises". This view is further supported by the findings and conclusions of the Carroll report. In the report, the reference to associated enterprises was made when the verification of business between the local subsidiary, parent company or other subsidiary companies of the parent was discussed. [52]

Article 9 uses the criteria of participation in the management, control or capital of an enterprise. The terms "participation", "management" and "capital" are not defined in the OECD model. Only the term "control" is defined in the OECD glossary of tax terms. Control is defined as "the capacity of one person to ensure that another person acts in accordance with the first person's wishes or the exercise of that capacity. The exercise of control by one person over another would enable individuals and corporations to avoid or reduce tax liability". There is no guidance available in the commentary as to how these three criteria should be applied.

Given the lack of guidance or definition on the criteria of participation in the management, control or capital of an enterprise, different authors have attempted to come up with their definition of these terms. We will first look at the meaning of the term "control". Dwarkasing traces the chronological development of Article 9 to find out the original intent behind the Article. The original form of Article 9 in 1933 used the term "dominant participation in the management or capital of an enterprise". This indicates that association between enterprises can only exist if the participation in capital or management can dominate or control the company i.e. not all types of participations is included. He thus argued that OECD did not consider participation in "control" to be a separate independent criterion. He cited Carroll who referred to the concept of interconnection envisaged under company law.[53] The expression "dominant participation in management or capital" was replaced by the expression "participation in management, control or capital" by the Fiscal Committee of the OEEC. Based on various reports of the Fiscal Committee, Dwarkasing took the view that the Fiscal Committee used the word "control" as a generally accepted term. There was no intention to vary the scope covered under Article 9(1) with the revised wording. It was simply a redrafting i.e. the term "control" was used to replace the term "dominant".[54]

Moving further into the meaning of the terms "participation in management or capital", from a company law perspective, Dwarkasing suggested that the terms "participation in capital" and "participation in management" referred to the controlling power that shareholders and management have over the enterprise respectively.[55] Putting all these concepts together, this would mean that for Article 9 to apply, we are literally looking at a situation where participants in capital and management are able

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52 Dwarkasing, op. cit., at pg. 123 and 124.
53 Ibid., at pg. 303.
54 Ibid., at pg. 330 and 331..
55 Ibid., at pg. 155.

to influence the transfer prices of the enterprise. Vogel interprets the criteria in a similar manner. He held the view that the mere existence of interconnection or the exercise of influence under company law was not sufficient to trigger Article 9(1). Adjustments under Article 9(1) can only be made if the interconnection was the cause of special conditions being made or imposed beyond arm's length. There are no maximum or minimum limits specified under the Article.[56]

Dwarkasing also expressed the view that that the notion of "de facto control" used in IAS/FRS should not be confused with control originating from de facto situations, such as mere economic dominance. The concepts of control and association in financial accounting supports the view that control, for the application of ALP, does not cover mere economic dominance, outside relationships vested in company law.[57]

Having discussed the "control" criterion, we move on to the "capital" criterion. Participation in capital can be considered by far to be the most common form of association.[58] Vogel referred to the bracket definition of "associated enterprises" as found in the Commentary to the OECD MTC as the start point i.e. "parent and subsidiary companies and companies under common control". Dwarkasing expanded on Vogel's view. He highlighted that the required relationship is based on shareholding i.e. participation by the parent in the capital of the subsidiary. Capital is raised in the form of equity or financing through borrowings.[59] Company law covers shareholders' relationships and the relationships between management, shareholder and the company. It deals with the capital stock of the company and the relationship between the investor and the managers.[60] As mentioned above, Article 9 does not provide a maximum or minimum limitation with regards to direct or indirect participation in the capital of an enterprise. What matters is the extent of control/influence that a shareholder has over an enterprise of another contracting state as a result of such participation. Specifically in the context of Article 9, the crux of the issue is whether this shareholder is able to control the transfer prices between the two enterprises. Control can be defined as the power to direct the strategic financial or operating activities of an entity, and thus the right to exercise whatever discretion in strategic decision-making.[61]

Finally, we move on to the criterion of "management". Dwarkasing referred to the commentary to Article 4 found in the 1927 report of the second Committee of Technical Experts.[62] In the commentary, he noted that the term "management and

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56 Vogel, op. cit., at pg. 525 and 526..
57 Dwarkasing op. cit., at pg. 237.
58 Ibid, at pg. 134.
59 Pette, B. Company Law, 2nd ed (Essex: Pearson Education Ltd, 2005), at pg. 270-280.
60 Dwarkasing op. cit., at pg. 135 and 147.
61 Ibid., at pg. 153.
62 League of Nations, Report on Double Taxation and Tax Evasion, presented by the Committee of Technical Experts on Double Taxation and tax Evasion, Document C116,M85(Geneva/London:12 April 2017), at pg. 272.

control" was used together when references were made to the real centre of control in the determination of residence. Based on his observation, he expressed the view that there was a special meaning and purpose behind this combination of "management and control" i.e. to prevent evasion and tax avoidance. Article 5 of the 1927 Draft Convention, the predecessor of today's Article 9, which dealt with the taxation of permanent establishments used similar phrasing. He drew similar inferences that the intent of the use of these words was to also prevent evasion and tax avoidance in the Article. The term "participation in the management or capital of an enterprise" found its way into Article 5 of the draft Convention of the 1933 Report, the predecessor of Article 9. These terms have remained in Article 9 since then.

From the authors' perspective, the chronological development of Article 9 is critical to understanding the intended scope of the Article. The bracket definition in the commentary to Article 9 is in line with the development of Article 9. The authors are of the view that Article 9 was intended to apply to parent and subsidiaries, and companies under common control i.e. companies in the same group that belonged to the same ultimate parent. As mentioned above, it was clear that the original intention was to ensure the proper allocation of profits between enterprises that had common ownership of stock or capital. This observation is supplemented further by the fact that this issue was originally addressed in the same manner as PEs and its head office, which could be seen as the closest analogy.

The authors would argue that all three elements of participation in capital, management and control have to be present for two enterprises to be considered as associated for the purpose of Article 9. The authors agree that the interconnectedness that we are looking for in Article 9 may be found in company law which governs the relationship between the companies. However, mere interconnectedness is insufficient for the application of the Article. It has to be demonstrated that such interconnectedness leads to an ability to influence the transfer pricing between enterprises before this Article can be applied. Mere passive shareholding, even a majority shareholding, would be insufficient if there is no ability to influence the operations of the company strategically. There has to be management that results in control. The application of Article 9 requires a qualitative assessment that these conditions are met.

The authors note that many countries do apply quantitative criteria for e.g. specific percentages in their domestic legislation to define associated enterprises.[63] It could be argued that the qualitative assessment that is required under Article 9 is replaced if countries were to apply only their quantitative approach when applying Article 9. Where both the qualitative and quantitative approaches yield the same outcome, Article 9 can be triggered to remove any economic double taxation that results. Where there is a disparity, Article 9 cannot be used. If we were to go by our view that there is an autonomous interpretation to the term associated enterprises,

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63 Dwarkasing op. cit, at pg. 153.

countries should perhaps not apply their domestic thresholds to determine which enterprises should fall under Article 9. As aptly pointed out by Dwarkasing, if a blunt shareholding percentage is used, it may not always be the case that a shareholder with that level of holding would always be in control of the enterprise.[64] Article 9 may be end up being wrongly applied.

When the concept of associated enterprises was first derived and first defined, the OECD or its predecessors worked on the basis that there was a general level understanding of the terms “control”, “under common control”, “associated enterprises”. Thus there was no need to define these terms specifically.[65] Given the passage of time and the evolution of business models, looking at the way different indicia that has been used by jurisdictions in domestic law to define related parties or associated enterprises e.g. common management etc. (please refer to section 4.3 below), the authors would like to suggest that there might be a possibility that the general understanding of the terms “control”, “under common control” may have changed. For example, many jurisdictions have used the criterion of common directors on the boards of two different enterprises to define association. In the present day, putting aside the need to ensure that the director exercised his fiduciary duties towards both enterprises, it might potentially be true that such a relationship would enable the director to literally influence the transfer prices between these two enterprises. This is especially so in this day of increasing mobility of individuals and with the advent of technology that greatly facilitates real time communication across borders. These two enterprises could fall under the scope of Article 9. Hence, there may be room to read the scope of Article 9 to encompass companies that share common directors on their respective boards. Based on the authors’ assessment, the wording of the Article 9 would be broad enough to accommodate such an interpretation.

To achieve maximum effectiveness for Article 9, the authors share Dwarkasing’s views that the OECD could provide more clarity on the definition of associated enterprises, the concept of “associated enterprises” should not be broadly interpreted and the “element of control” is not an independent criterion.[66] More clarity on the definition would help two contracting States apply the Article better and help to eliminate economic double taxation. Having a tighter definition would be akin to finding the lowest common denominator that makes the article acceptable to most jurisdictions thus improving its effectiveness. Lastly, the “control” criterion is the key to the objective of the Article. The ability of one enterprise to “control” the other enterprise is necessary before the Article should be applied.

The next section of this paper looks at the definition of “associated enterprises” and “related parties” that are used domestically by different enterprises.

64 Dwarkasing op. cit, at pg. 156.
65 Vogel, op. cit., at pg. 529.
66 Dwarkasing op. cit, at pg. 584.

4.3. Domestic tax law definitions of associated enterprises

To understand how jurisdictions define the associated enterprises that fall within the scope of their transfer pricing regimes, a representative selection of jurisdictions were reviewed. The jurisdictions surveyed include those of developed and developing countries, as well as different regions globally, namely the Americas (the United States, Canada), Europe (the United Kingdom, Germany, France, Belgium, the Netherlands, Switzerland, Luxembourg, Ireland), the Asia Pacific (Japan, Korea, India, China, Australia, New Zealand) and the smaller subset within the Asia Pacific of Southeast Asian jurisdictions (Malaysia, Thailand, Indonesia, Vietnam, Singapore). A key challenge faced by jurisdictions in defining the associated enterprises that fall within their transfer pricing regimes is where to place this definition within a whole spectrum of possibilities, particularly in view of the interconnectivity of businesses and global supply chains. On one end of the spectrum, jurisdictions could adopt a more formalistic approach using quantitative thresholds (e.g. extent of participation in capital). On the other end of the spectrum, jurisdictions may instead adopt a more qualitative approach (e.g. based on substance).

However, while the OECD MTC adopts the notion of 'associated enterprises' in Article 9, many of the jurisdictions surveyed do not necessarily use the same term or notion in their transfer pricing regimes. Jurisdictions that adopt the term 'associated enterprises' in their transfer pricing legislation generally have domestic definitions of the term that may contain similar wordings as the OECD MTC or its commentary, but often these domestic definitions extend beyond the definition provided by the OECD. For example, in the case of India,

> *"…associated enterprise", in relation to another enterprise, means an enterprise—*
>
> *(a) which participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or*
>
> *(b) in respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise.'*[67]

This definition of associated enterprises is reminiscent of that found in Article 9 of the OECD MTC. However, India's Income Tax Act then elaborates upon its definition of

[67] Section 92A. (1), Chapter X, Income Tax Act 1961.

associated enterprises by specifying thirteen circumstances whereby associated enterprises would be established.[68] For instance, one scenario involves an enterprise holding, directly or indirectly, shares carrying not less than twenty-six per cent of the voting power in the other enterprise at any time in the previous year, while another scenario describes an enterprise guaranteeing not less than ten per cent of the total borrowings of the other enterprise at any time in the previous year. A summary of the thirteen circumstances contained in the definition is at Appendix 1. Such elaborations on the term 'associated enterprise' clearly extends beyond the interpretation provided for in the OECD MTC and its commentary.

Most of the jurisdictions surveyed refer to 'related parties' or 'related persons' in their domestic transfer pricing regimes instead of the term 'associated enterprises'. The authors are of the view that a possible explanation points towards how domestic legislation had evolved with the use of 'related parties' or 'related persons' in other parts of the domestic tax law, and thus a natural extension of the use of the term was adopted for transfer pricing purposes. On the other hand, the term 'associated enterprises', as detailed above, developed relatively independently in the context of the OECD MTC and its associated texts. We discuss later at section 5 an analysis with regard to Singapore's case.

A brief summary of the definition of related parties / related persons / associated enterprises (referred to simply as related parties henceforth in this Section) for the surveyed jurisdictions may be found in Appendix 1. We discuss our key observations in the remaining paragraphs of this section.

Firstly, we observe that most jurisdictions make reference to the concept of 'control' in determining if two parties are related for the purpose of transfer pricing. However, the concept of 'control' is defined to varying extents by each jurisdiction. There are generally two models adopted by jurisdictions in defining control. One model is through consideration of either (i) the holding of shares above a certain threshold, or (ii) control in substance (i.e. as a qualitative assessment or via specifically identified scenarios). Control is therefore established where either (i) or (ii) takes place. The second model does not prescribe the holding of shares above a threshold percentage to define control, but instead focuses on merely determining if there is control in substance (i.e. (ii) in the preceding sentence).

Where jurisdictions consider control to be present if there are shareholding relationships, the legislative scope generally covers shares held directly or indirectly of one party by the other party or vice versa, or where there is a third party that holds directly or indirectly shares of the two parties concerned. This is not unlike the description of the participation in capital between associated enterprises envisioned under Article 9 of the OECD MTC. In terms of the shareholding percentage thresholds adopted by these jurisdictions, they typically cluster around two points: twenty-five or

[68] Section 92A. (2), Chapter X, Income Tax Act 1961.

twenty-six per cent (e.g. China, Germany, India, Indonesia) and fifty or fifty-one per cent (e.g. Ireland, Japan, Malaysia, South Korea). Where control is determined via a shareholding threshold, this is a fairly blunt test. Take for example, for an enterprise in China, where one shareholder holds only fifteen per cent of another enterprise, but this shareholder holds the single largest share due to diversified holdings of the remaining shares, this shareholder would have sufficient voting power to control the other enterprise but not be caught under the associated enterprise definition in China.[69]

How control is to be determined in substance presents an even broader range of definitions amongst the jurisdictions surveyed. Most jurisdictions use one or a combination of the following concepts:

a) Participation in the management, control or capital of the other party, using the same or similar wording as that found in Article 9 sub-paragraphs 1a) or 1b)of the OECD MTC;

b) Dependence through financial relationships where there is an extension of loans or guarantees to the other party;

c) Dependence through business relationships e.g. measured by the purchases and/or turnover of the business;

d) Common member or members of the Board of Directors of the other party;

e) Dependence on the personnel of the other party;

f) Dependence on the intangibles or technologies supplied or held by the other party; or

g) Other specific definitions provided for by some jurisdictions regarding what constitutes control, that are usually conceptual in nature. For example, Germany describes a situation where there is a direct or collateral possibility to exert a dominating influence to the related party, while Belgium states specifically that its transfer pricing legislation may apply to third parties.

While every jurisdiction surveyed has its own provisions defining the scope of related parties falling under its transfer pricing regime, a unique treatment exists for the case of Switzerland. For Switzerland, there are no specific definitions of related parties and instead direct reference is made towards the application of the OECD TPG, including the definition contained within with regard to associated enterprises.[70] It is noteworthy to mention that Switzerland's adherence to the OECD TPG applies to

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[69] Dwarkasing op. cit., at pg 156.

[70] Circular letter issued by the Director of the Swiss Federal Tax Administration to the Cantonal Tax Administrations.

all subsequent updates to the Guidelines, e.g. changes to the Guidelines resulting from the BEPS Action Plan.

Australia is another jurisdiction that makes reference to the definition of associated enterprises contained in the OECD TPG, but by way of referring to the definitions of associated enterprises adopted in the relevant tax treaties, where applicable. Unlike many other jurisdictions, Australia does not in the first instance determine the related parties that fall within the scope of its transfer pricing legislation but instead determines that its transfer pricing regime applies if there is a 'transfer pricing benefit'.[71] This benefit is then defined in the context of the Associated Enterprises Article in its tax treaties where relevant, or a similar concept in cases where no tax treaties apply. In other words, while Australia has its own comprehensive set of domestic transfer pricing legislation, for the purpose of defining the entities and consequently transactions that fall within its regime, there is a degree of alignment with the definitions of associated enterprises adopted in its tax treaties.

None of the surveyed jurisdictions impose their transfer pricing regimes on unrelated party transactions, but we note that a few jurisdictions, such as Brazil and Argentina, may in fact do so. Brazil, for instance, applies its transfer pricing rules on transactions that its taxpayers enter into with entities located in low tax jurisdictions, regardless of whether the parties transacting are considered related or not. The low tax jurisdictions are blacklisted in a Normative Instruction RFB No. 1,037/2010, amended in 2016 by a Normative Instruction RFB No. 1,658, released by Brazil's Federal Revenue (RFB). The authors are of the view that such a policy reflects a transfer pricing regime directed towards counteracting tax avoidance, rather than one that seeks to ascertain a fair allocation of profits to be taxed amongst jurisdictions.

4.4. Definitions of associated enterprises for customs purposes

In addition to Article 9 of the OECD MTC and domestic legislation dealing directly with transfer pricing, there are other aspects of international and / or domestic laws that could either rely on or impact the concept of associated enterprises for tax purposes. One such area pertains to customs duty, which is imposed primarily on the customs value of imported goods.[72] The WTO Valuation Agreement sets out the customs valuation methodology that WTO Member countries are obligated to adopt and the 'transaction value' is mainly used to determine the customs value.[73] There are generally two components to the transaction value: the price actually paid or payable for the imported goods and a series of cost elements not included in the invoice price (adjustments). This second component could include, for example, royalties or license

[71] Section 815.15, Income Tax Assessment Act 1997.

[72] World Customs Organization, WCO Guide to Customs Valuation and Transfer Pricing, WCO June 2015, Chapter 2, Para 2.1.

[73] WTO, Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (GATT) 1994, General Introductory Commentary.

fees related to the goods that the buyer must pay as a condition of sale of the goods, to the extent that the royalties or license fees are not included in the price actually paid or payable on the goods.

Based on Article 1 of the WTO Valuation Agreement, the acceptability of the price actually paid or payable is affected by a number of conditions, one of which is where the buyer and seller of the goods are related. For this purpose, the Agreement defines related parties as follows:

"…(a) they are officers or directors of one another's businesses;

(b) they are legally recognized partners in business;

(c) they are employer and employee;

(d) any person directly or indirectly owns, controls or holds 5 per cent or more of the outstanding voting stocks or shares of both of them;

(e) one of them directly or indirectly controls the other;

(f) both of them are directly or indirectly controlled by a third person;

(g) together they directly or indirectly control a third person; or

(h) they are members of the same family."[74]

Besides the WTO Valuation Agreement, some jurisdictions have their own definitions of related persons for customs valuation purposes in their domestic laws. For example, the United States defines related persons for such purposes as members of the same family, shared officers or directors, partners, employers and employees or a party with at least five per cent controlling interest in the other.[75]

The mere existence of related buyers and sellers is insufficient grounds to disregard the transaction value. There must be evidence that the relationship had influenced the price.[76] The WCO Guide to Customs Valuation and Transfer Pricing acknowledges that since the aim of the determination of prices for customs as well as transfer pricing purposes is the same, i.e. to seek an arm's length price, transfer pricing documentation may provide useful information for customs purposes authorities on a case by case basis. Indeed, this was previously confirmed through the adoption by the WCO of Commentary 23.1, developed by the WCO's Technical Committee on Customs Valuation in response to proposals by a WCO focus group consisting of customs officials, tax officials and business representatives. This consistent recommendation arises despite the acknowledgement that there could nonetheless be differences in the approaches for customs compared to income tax.

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74 Ibid, Article 15.4.

75 19 CFR §152.102(g).

76 World Customs Organization, op cit., Chapter 2, Para 2.1.

This paper does not set out to discuss the issues arising from the reliance for customs purposes on transfer pricing documentation. The recommendation to obtain useful information from transfer pricing documentation where relevant presents an avenue for taxpayers to leverage on resources and demonstrate consistency in the application of the arm's length principle. However, the authors are of the view that if one were to approach the recommendation from the consideration of what is defined as related persons, it is clear that the scope of related persons for customs purposes is different from the scope of related persons for transfer pricing purposes. For instance, a mere 5% shareholding by a third party of both the seller and buyer would deem the buyer and seller to be related parties for customs purposes. However, this single fact does not signal the existence of associated enterprises under Article 9 of the OECD MTC or related parties in the domestic transfer pricing jurisdictions surveyed. In such an instance, there would be no meaningful leverage on transfer pricing analysis since there is likely to be no transfer pricing documentation prepared in the first place.

4.5. Definitions of associated enterprises for accounting purposes

From an accounting perspective, International Accounting Standard (IAS) 24 - Related Party Disclosures requires disclosures about transactions and outstanding balances with an entity's related parties. In the context of a company, the categories of entities and people defined as related parties are where:

i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others);

ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member);

iii) Both entities are joint ventures of the same third party;

iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity;

v) The entity is a post-employment defined benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity;

vi) The entity is controlled or jointly controlled by a person who is identified as a person / close member of that person's family that is related to a reporting entity;

vii) A person, who is a person or a close member of that person's family that is related to a reporting entity and has control or joint control over the reporting entity,

has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity); or

viii) The entity, or any member of a group of which it is a part, provides key management personnel services to the reporting entity or to the parent of the reporting entity.

In addition to stating what are the related parties to be disclosed in the financial statements, IAS 24 also states what instances are deemed not to be related, namely:

i) Two entities simply because they have a director or key manager in common;

ii) Two venturers who share joint control over a joint venture;

iii) Providers of finance, trade unions, public utilities, and departments and agencies of a government that does not control, jointly control or significantly influence the reporting entity, simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process); or

iv) A single customer, supplier, franchiser, distributor, or general agent with whom an entity transacts a significant volume of business merely by virtue of the resulting economic dependence.

IAS 24 ensures that the necessary disclosures are disclosed in a reporting entity's financial statements, to make known the possibility that the entity's financial position may have been affected by what are considered under the standard to be related parties, and by transactions and outstanding balances with such parties. Thus, it is not surprising that the definition of related parties provided for under IAS 24 (and other accounting standards concerning related parties) is extensive and covers more entities and situations compared to those found under Article 9 of the OECD MTC or individual jurisdictions' domestic transfer pricing regimes.

On the other hand, IAS 24 makes it clear that two entities with joint control in a joint venture do not constitute related parties. The concept of economic dependence through a major supplier or customer is also not present under IAS 24. It would appear that generally there is seemingly less reliance under IAS 24 on the determination of control from a substance perspective. Thus while the definition of related parties under IAS 24 is generally broader than that for transfer pricing purposes, there could be specific instances, particularly where the domestic transfer pricing regime applies a prescriptive definition for related parties, parties considered related for transfer pricing purposes may not be disclosed in the financial accounts.

The problem arises when the definition of related parties used for accounting disclosure purposes is used for tax reporting or even audit purposes. Ideally, tax authorities should recognize that the related parties disclosed in financial statements hold limited meaning from a tax perspective. To determine the level and nature of

related party transactions for an entity for transfer pricing purposes, it is still preferred that a definition of related parties as close to, if not the same as, the definition for transfer pricing purposes is used. The authors are of the view that the definition of related parties for transfer pricing purposes could already be vastly different upon analysis of Article 9 of the OECD MTC compared to domestic transfer pricing regimes, so the use of accounting definitions for tax purposes adds an unnecessary layer of complexity to the issue (see section 6.4).

4.6. Interaction between domestic tax law and international tax law

Tax treaties are meant to restrict the application of domestic tax rules.[77] Where a jurisdiction's domestic legislation imposes profit adjustments on enterprises which are associated by definition but where there is no control, it is arguable that the jurisdiction is not acting in accordance with Article 9(1) of the treaty and the other contracting state is not obliged to provide double taxation relief under Article 9(2). It would also be arguable that given Article 9(1) is only applicable in the transactions between associated enterprises, if a jurisdiction makes adjustments on the transactions between two enterprises which are not associated under the treaty, but associated under domestic law, the Article would not be applicable.

That said, in an ideal world where all enterprises transact on similar terms and conditions regardless of association by control or definition and all jurisdictions have the same view on what is ALP, there would not be a need for transfer pricing adjustments to be made. The disparity between the definitions of associated enterprises in domestic law and treaty law would not matter. However, in our imperfect world, some enterprises do not transact on an arms' length basis. Different jurisdictions have a different view on what is considered arms' length under the same fact pattern. Hence, instances of unrelieved economic double taxation would occur where the jurisdiction make transfer pricing adjustments in respect of enterprises that are not covered under the scope of Article 9. A possible solution would be for both contracting states to find a solution via Art 25(3) to remove the economic double taxation.[78]

5. Singapore's context

5.1 Definition of related party in Singapore's tax treaties

Singapore's treaties have consistently followed OECD's Article 9(1) in almost its entirety. While there are some slight deviations in terms of the drafting for Article 9(1) for some of the older treaties, these are mainly editorial and do not change the meaning of Article 9(1). Singapore has not made any reservations on Article 9 in the

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77 Vogel, op. cit., at p. 521. Similar view expressed in United Nations, *United Nations Practical Manual on Transfer Pricing for Developing Countries*, para 1.7.13 and 1.7. 14.

78 Similar conclusion drawn in Dwarkasing op. cit, at pg. 568.

OECD MTC 2014. It is interesting to note that there are actually no reservations or observations by any OECD or non-OECD jurisdictions in respect of Article 9(1).

Singapore has a dualistic system. Parliamentary consent is not necessary for the conclusion of tax treaties. Bilateral treaties that are signed with Singapore require enabling legislation before they are given legal effect.[79] Treaties restrict the application of domestic law in Singapore.

5.2 Definition of related party under Singapore domestic tax law

Singapore's domestic law for making transfer pricing adjustments comes from Section 34D of the Singapore Income Tax Act (SITA). Section 34D gives the comptroller the authority to make transfer pricing adjustments to bring the results back to arm's length between related parties. While the wording of Section 34D is very close to that of Article 9(1) of the OECD MTC, Section 34D does not use the term "associated enterprises". On the contrary, Section 34D only uses the term "related parties". The definition of "related party" is defined in Section 13(16) of the SITA as follows:

> "related party" in relation to a person, means any other person who, directly or indirectly, controls that person, or is controlled, directly or indirectly, by that person, or where he and that other person, directly or indirectly, are under the control of a common person.

Based on Section 13(16) above, two persons are related to each other if one person controls the other either directly or indirectly. Two persons can also be related to each other if they both come under the direct or indirect control of the same person. There is no specific definition of 'control' under the SITA.

In fact, this definition of related parties under Section 13(16) is not used exclusively for transfer pricing purposes. Section 34D was legislated in 2009 but the definition of related parties under Section 13(16) was already in existence before that and used by other sections of the SITA. The other sections of the SITA that rely on the same definition are:

(i) Limitations on the deduction for expenditure on licensing intellectual property rights and the writing down allowances for intellectual property rights acquired under Sections 14W and 19B respectively;

(ii) Restriction on the exemption of certain sources of income under Section 13; and

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[79] Section 49 of Singapore Income Tax Act (Chapter 134).

(iii) Restriction on the concessionary rate of tax for income derived from debt securities under Section 43N.

However, the concept of ‘control’ between two persons in the SITA is not confined only to Section 13(16). Section 24, for example, deals with the capital allowances consequences in a situation where there is a sale of property and the buyer is a person over whom the seller has control, or the seller is a person over whom the buyer has control, or both the seller and buyer are persons and some other person has control over both of them. Such a description is similar to the definition contained within Section 13(16), yet a separate definition was used without the need to refer to Section 13(16).

In general, Section 13(16) can be said to be broader in scope than Article 9(1). It is possible that transfer pricing adjustments might be carried out in Singapore under Section 34D which would not be covered under Article 9 of Singapore’s treaties. There are some similarities between Section 13(16) and Article 9(1) of the OECD MTC. Both rely on the notion of having control. At a general level, association is created where one person is a shareholder of the other person; or if both persons have common shareholders. On the other hand, Section 13(16) applies to both enterprises and non-enterprises. Section 13(16) also did not limit the type of situation under which control may be exercised i.e. it seems as long as control can be established between two parties, they are considered related. This is different from Article 9(1) which requires participation in management, capital or control.

In a treaty context, given that Singapore did not express any reservations on Article 9 of the OECD MTC, Singapore would likely take the position that there is an autonomous interpretation of Article 9(1). At present, this is an untested area in terms of the application of Singapore’s treaties. Hence, it is unclear exactly how Singapore would interpret the scope of Article 9(1). As there is not much guidance in the commentary to the OECD MTC on the interpretation of Article 9(1), it is possible that Singapore would rely on the bracket definition of associated enterprises. This position would be aligned to what is done in practice. The most common situation encountered under Article 9 would be in respect of transactions between parent and subsidiaries or subsidiaries belonging to the same group.

In view of the above, it would be useful if there could be further guidance given by Singapore in respect of Section 34D. Singapore could share on the objectives of Section 34D and its scope of application. A more specific definition and scope of related parties for the purpose of transfer pricing and the application of Section 34D could be legislated instead of placing reliance on the definition contained in Section 13(16), which currently serves multiple purposes.

Given the lack of guidance from the OECD on the exact definition of Article 9(1), it would be difficult for Singapore to express a position on how it would read Article

9(1). As pointed out in earlier paragraphs, most instances of transfer pricing adjustments encountered i.e. in respect of parent and subsidiaries or subsidiaries belonging to the same group have already been addressed. There should be limited practical impact arising from the dichotomy between related parties and associated enterprises in a Singapore context.

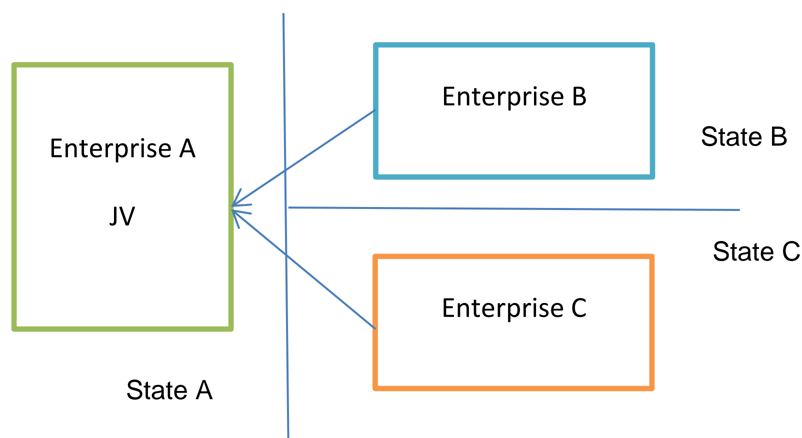
6. Practical implications

Based on our analysis above, the authors would like to point out certain practical implications that were not considered in both Article 9(1) of the OECD MTC or domestic transfer pricing legislation.

6.1. Joint Ventures

A joint venture (JV) is a business entity created by two or more parties, generally characterized by shared ownership, shared returns and risks and shared governance. Most JVs are incorporated, although in certain industries such as in oil and gas, JVs may be unincorporated but mimic a corporate entity. For the purpose of this paper, the authors would like to distinguish a JV from an entity within the MNE group that is not wholly owned. Group entities may not be wholly owned for a variety of reasons for e.g. legacy reasons or for regulatory reasons where foreign ownership of local entities is not allowed etc.

Assume the case of a JV in State A, that is made up of two enterprises in States B and C, both having equal ownership. As a result, both parties would have equal returns and risks and governance.



In the interest of the States A, B and C, the profits arising from transactions between Enterprises A and B and Enterprises A and C should be properly allocated. Enterprises B and C are unrelated parties.

Given that both enterprises have the same level of control over Enterprise A, Enterprises B and C would ensure that transactions are carried out at arm's length. Although there does not seem to be much concerns in this instance, for the purpose

of this paper, the crux of the issue would be whether Enterprise A can be considered to be an associated enterprise of Enterprises B or C under Article 9(1) of the OECD MTC. The question is whether joint control is envisaged in the context of Article 9(1). If we take into consideration the notion of dominant control as described earlier in this paper, given that neither Enterprise B nor C has dominant control over Enterprise A (there is equal control), the authors would argue that Enterprises B and C are not associated enterprises of Enterprise A. This view is also supported by Dwarkasing.[80]

If the facts of the case were to be tweaked such that Enterprise B now has a greater share of ownership of Enterprise A than Enterprise C, based on a literal reading of Article 9(1), the authors would now argue that Enterprise B would have dominant control over Enterprise A by virtue of its majority participation in the capital of Enterprise A. Enterprises A and B are associated enterprises. However, if we were to look deeper into this, we could argue that Enterprise C, being unrelated to Enterprise B, would seek to ensure that transactions between Enterprise A and B would be conducted at arm's length. The nature of these transactions would not fall under the original intent of Article 9(1).

Practically, this presents the question of whether transfer pricing analysis and documentation would be required for JVs or for certain JVs depending on their structures. For countries that adopt the concept of control in substance in their domestic transfer pricing regimes, an enterprise transacting with its JV could arguably fall outside of the regime if there is a case to state that there is no control of the JV. For example, if there are two unrelated investors to the JV having equal decision making or voting rights, each investor cannot be said to be in control of the JV. However, some jurisdictions may hold the view that joint control reflects control in substance, even if the investors to the JV are unrelated and could even be industry competitors, as the JV reflects a common interest for its investors and transfer pricing therefore applies to the transactions between its investors and the JV.

Some jurisdictions that prescribe a threshold for shareholding to determine control do so by reference to the enterprise's share of voting rights or income distribution. If so, it is also likely that the enterprise would be considered a related party of its JV if its share of voting rights of or income distribution from the JV exceeds the prescribed shareholding threshold. Another approach is to prescribe a specific shareholding threshold to apply to JVs. For example, in the United Kingdom, the shareholding threshold applied for JVs is 40%.[81]

The disparity of the treatment of JVs by jurisdictions in determining if and which transactions with an enterprise's JVs fall under their respective transfer pricing regimes results in some degree of asymmetry in the need for transfer pricing analysis and documentation for such transactions. Furthermore, the interaction of the

[80] Dwarkasing op. cit, at pg. 171.

[81] Taxation (International and Other Provisions) Act 2010, Part 4, Corporation Tax Act 2010, Section 1124

jurisdictions' domestic transfer pricing regimes with the respective jurisdictions' interpretations of Article 9 of their tax treaties presents yet another layer of complication with regard to transfer pricing risk management and protection from double taxation.[82]

Based on the above, it is worth having further thoughts on the topic of JVs. The concept of JVs is not quite the same as the concept of group entities. Group entities are generally related based on common control throughout the group. On the other hand, JVs and the parties constituting the JVs are unrelated to begin with. Based on the original intention and scope of Article 9(1), the authors are of the view that JVs should not be caught within the scope of associated enterprises. In this respect, more guidance and clarification from the OECD on this point would be helpful. That said, if there are concerns of JV parties colluding and transactions between JVs and the JV parties are not at ALP, this problem should be addressed from an anti-avoidance perspective and not through Article 9.

6.2. Family owned companies/businesses

Article 9 works on the premise of determining participation under company law. It is based on the traditional model of company ownership with a parent at the top of the hierarchy. Management of the group of companies is generally centralized. However, not all companies are owned or managed in this manner.

Family owned companies/businesses may differ in terms of holding structure from the traditional model that has been discussed throughout the paper. For the purpose of this paper, "family business" is defined as a business where:

a) The majority of votes are held by the person who established or acquired the firm (or their spouses, parents, child, or child's direct heirs);

b) At least one representative of the family is involved in the management or administration of the firm;

c) In the case of a listed company, the person who established or acquired the firm (or their families) possess 25% of the right to vote through their share capital and there is at least one family member on the board of the company.[83]

These companies/business can range from small and midsized companies to big companies such as BMW, Samsung and Wal-Mart stores. Many of these family businesses are privately held holding companies with reasonably independent subsidiaries that might be publicly owned. [84] In some instances, the family may hold the business through private trusts. In general, the family holding company might fully

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82 Dwarkasing op. cit, at pg. 173.

83 PwC Family Business survey 2014.

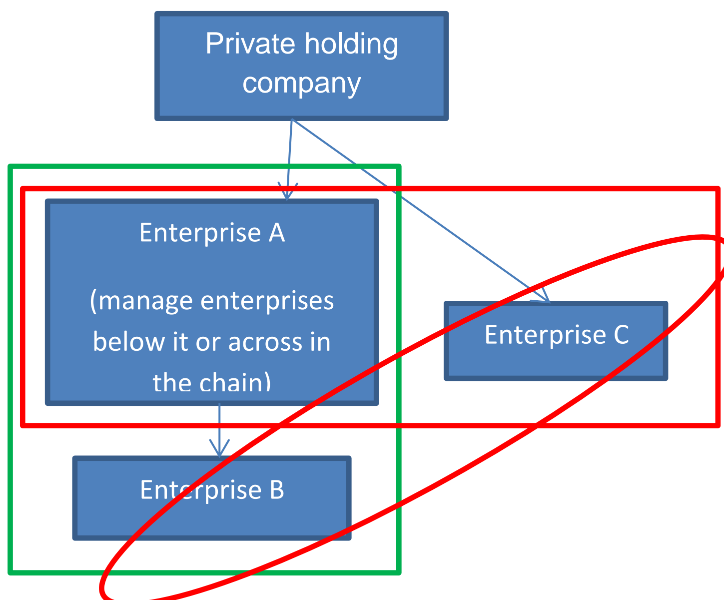
84 Casper C. et al, 'The five attributes of enduring family business', Mckinsey & Company, January 2010.

control the more important subsidiaries. By keeping the holding private, the family avoids conflicts of interest with more diversified institutional investors looking for higher short-term returns. Financial policies often aim to keep the family in control.[85] Traditionally, most family business looked at passing on ownership and management to their next generation. However, this trend is now evolving. Many family businesses are looking at passing on only ownership, but not management to the next generation.

With the above in mind, the authors are of the view that there are ambiguities when it comes to the application of Article 9 of the OECD MTC and domestic transfer pricing regimes to family owned companies/businesses.

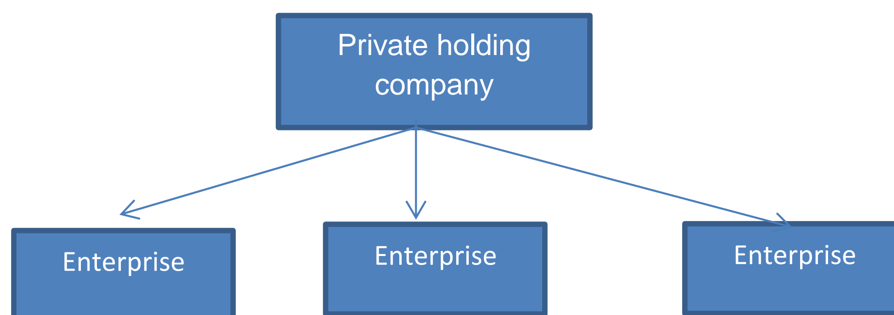
From an Article 9 perspective, its impact on family businesses can be looked at from different perspectives; namely family business owned via private holding company(ies) and family owned business owned via private trusts.

For family businesses owned via private holding companies, the authors are of the view that there could be two possible outcomes which is dependent on the ownership and management model of the holding companies. If the owners of the private holding company are also undertaking the management of the enterprises that it owns, the authors hold the view that Article 9 of the OECD MTC will apply. The private holding company can be said to participate in the capital, management and control of the other enterprises. In some instances, the owners of the private holding company do not undertake the management of the enterprises that it owns. It might have another enterprise below it in the structure where it employs professional management, which helps to manage and control the other enterprises further down or horizontally in the ownership chain. It could also have enterprises which are independently managed.



85 Ibid.

For such situations, the authors are of the view that the applicability of Article 9 becomes murky for the private holding company. While it is possible that the private holding company may still hold the majority shareholding in the other enterprises and be considered to participate directly or indirectly in the share capital of the enterprises, it is arguable if it can be considered to have control of the enterprise or participation in management of the enterprise i.e. it is not as clear if the other enterprises can be considered to be associated enterprises of the private holding company.[86] For the other enterprises, Enterprises A and B are likely to be associated enterprises by virtue of Article 9(1)(a). This is one of the most common scenarios. The situation is a little unclear as to whether Enterprises A and C are likely to be associated enterprises by virtue of Article 9(1)(b). The private holding company can be said to participate directly in the share capital of both Enterprises A and C. Given that we are not clear if Enterprise A and private holding company has an association, to the authors, it is not clear if the private holding company can be said to be participating in both the management, control or capital of Enterprises A and C to create such association. For Enterprises B and C, the analysis would be the same as that of Enterprises A and C. From a practical perspective, this would mean that Enterprises A and B would potentially have no protection under Articles 9 and 25 for its transactions with Enterprise C, although Enterprise A would have some control over these transactions in effect. It is unlikely that there would be many transactions between the private holding company and the enterprises.



In the scenario above, if the private holding company holds enterprises that are independently run, the authors hold the view that the enterprises should not be considered as associated enterprises of the private holding company. The enterprises should also not be considered as associated enterprises with respect to one another. Between the private holding company and the enterprise, while the private holding company participates in the capital of the enterprise, given that the enterprise are independently managed, it might be difficult to argue that the private holding company participate in the management of these enterprises or have control of these enterprises. In terms of the relationship between the enterprises, given that the enterprises cannot be said to be associated enterprises of the private holding, by

86 Please refer to section 4.2.

extension, Article 9(1)(b) cannot apply. Similarly, if each of the independently run enterprises have a group of enterprises under it, the authors would hold the view that the groups are not associated with each other. Only enterprises within the same group can be said to be associated enterprises of each other, subject to their holding structure.

In view of the above, it can be seen that Article 9 was not envisaged to be applied to family owned companies. Should the OECD consider clarifying the definition of "associated enterprises", this would be another area for the OECD to address. The authors hold the view that the definition of associated enterprises should not be overly broad. It should encapsulate the notion of common control throughout the chain of enterprises i.e. only groups of enterprises which are centrally controlled should be captured under the definition.

6.3. Comparability

Article 9 calls for associated enterprises to transact on the same terms and conditions as unrelated enterprises. In practice, the terms and conditions under which unrelated enterprises transact are found and applied to transactions carried out between associated enterprises. Some authors have criticized that it is a fallacy to be able to find transactions among unrelated parties which could be used as meaningful benchmarks.[87] This is evidenced by the increasing use of profit split methods by tax authorities in the absence of market comparables.[88] Based on the theory of the firm[89], internalization allows integrated enterprises to carry out transactions more efficiently than independent enterprises which must follow market prices. MNEs are created because they generate returns internally above what can be obtained in market transactions.[90] In view of these, it did not seem logical to find comparable transactions between unrelated parties and to use this result in transactions between associated enterprises.

From a domestic law perspective, many jurisdictions impose threshold requirements in their respective legislations to deem association for the purpose of transfer pricing. From a comparability analysis perspective, this has practical implications in the search for comparables to benchmark an arm's length outcome. Basically, this means that the comparables selected when benchmarking a particular transaction for an enterprise of a jurisdiction must have an independence criterion that is lower than the shareholding threshold applied in that jurisdiction to deem association

87 Avi-Yonah & I. Benshalom, 'Formulary apportionment – Myths and Prospects: promoting Better International Tax Policies by Utilizing the Misunderstood and Under-Theorized Formulary Alternative', 3 World Tax J. 3(2022), Journals IBFD at sec 2.2.

88 E. Baistrocchi, *The Transfer Pricing Problem: A Global Proposal for Simplification*, 59 The Tax Law. 4, pg. 949 (2006).

89 R. Coase, *The Nature of the Firm*, 4 Economics 16 (1937) and O.E. Williamson, *Markets and Hierarchies: Analysis and Antitrust Implications* (Free Press 1975).

90 R. Vann, Reflections on Business Profits and the Arm's-Length Principle, in The Taxation of Business Profits Under Tax Treaties (B.J. Arnold, J. Sasseville & E.M. Zolt eds., Can. Tax Fund 2003), at pg. 140.

in the domestic transfer pricing regime. For instance, Indonesia applies a 25% shareholding threshold in its transfer pricing regime to determine if two parties are related. Consequently, each external comparable selected in a benchmarking study to test a related party transaction must not have 25% or more of its shares held by any one shareholder. This translates to an independence criterion of 'B' in databases commonly used for benchmarking purposes, such as the Osiris or Oriana databases. For another jurisdiction such as Japan whose shareholding threshold for the determination of related parties in its domestic jurisdiction is 50%, the independence criterion applied would be 'A', i.e. no single shareholder holds 50% or more of the enterprise's shares. Where the related party transaction is one between an enterprise in Japan and another enterprise in Indonesia, care would have to be taken in the comparables search such that a 'B' criterion for independence is applied, even though from a Japan domestic tax perspective, companies with between 25% to 50% of its shares held by a single investor could still be treated as independent.

Putting the situation above into the perspective of Competent Authority discussions under Articles 9 and 25 of the OECD Model, given the lack of guidance on the exact definition of associated enterprises, various points of contention can be envisaged. For example, consider the scenario where a Japanese entity were to own 40% share capital of an Indonesian entity and the Indonesian tax authorities were to apply a transfer pricing adjustment to the transactions between the Indonesian entity and the Japanese entity. Assume taxpayers have filed for a mutual agreement procedure (MAP) between Indonesia and Japan. The Japanese Competent Authority could take the view point from their perspective that the transfer pricing adjustment should not be made. The Japanese and Indonesian entities could not be considered as associated enterprises under Article 9 of the OECD Model given that the Japanese entity did not own more than 50% of the Indonesian entity. The Indonesian Competent Authority would hold the view that the two entities are associated since the Japanese entity held more than 25% of the Indonesian entity. Assuming that both Competent Authorities agree to admit this case under MAP, the two authorities might continue to disagree in terms of the type of comparables that could be admitted for the purposes of benchmarking the tested entity. The Japanese Competent Authority might argue that only comparables with the BvD independence indicator of "A" can be admitted while the Indonesian Competent Authority might argue that comparables with the BvD independence indicators of "A" and "B" can be admitted. These issues of contention would detract both Competent Authorities from the main objective of eliminating economic double taxation between the two jurisdictions and finding the appropriate arm's length outcome in the transactions between the two enterprises.

Once again, the authors are of the view that greater clarity by the OECD in terms of the definition of "associated enterprises" would help to address the issue above on comparability.

6.4. Country-by-country reporting

The OECD developed a three-tiered standardised approach to transfer pricing documentation under BEPS Action 13. First, MNE are required to maintain a "master file" that can provide tax administrations with high-level information regarding their global business operations and transfer pricing policies. Second, a "local file" specific to each country is intended to provide details of the material related party transactions of the reporting entity, the amounts involved in those transactions and the reporting entity's analysis of the transfer pricing determinations with regard to those transactions. Third, large MNEs may file a country-by-country ("CbC") report containing information such as the amount of revenue, profit before income tax and taxes paid in each jurisdiction where the MNEs operate, as well as the location and main business of each constituent entity within the MNE group. These three documents (master file, local file and CbC report) are intended to lead taxpayers to articulate consistent transfer pricing positions. The documents will also provide tax administrations with useful information to assess transfer pricing risks, make determinations about where audit resources can be most effectively be deployed.[91]

MNE groups are required to file CbC Report if their annual consolidated group revenue were to exceed EUR 750 million or its domestic equivalent. A constituent entity that is reported in the CbC Report refers to the separate business unit of an MNE group that is included in the consolidated financial statements of the MNE group for financial reporting purposes.[92] Given that the CbC report forms part of the set of documentation that tax authorities can use for transfer pricing risk assessment purposes, this would potentially mean that tax authorities would interpret the constituent entities in the CbC Report, which has been identified based on financial accounting standards, as associated enterprises for transfer pricing purposes when they rely on the CbC Report to do their transfer pricing risk assessment. As mentioned in section 4.5 above, the authors are of the view that an issue would arise when the definition of related parties used for accounting disclosure purposes is used for tax reporting or even audit purposes. In the case of CbC reporting, tax authorities may end up with a slightly different pool of entities i.e. constituent entities versus associated enterprises for transfer pricing risk assessment. It is important that tax authorities recognize that the related parties disclosed in financial statements hold limited meaning from a tax perspective. If not, the authors are of the view that complications may arise. In particular, there is a danger that related parties as defined for financial reporting purposes may end up being wrongly identified as associated enterprises. If the tax authorities were to hold a different view on the appropriate transfer price that should be transacted between these entities, transfer pricing adjustments might result, for which, there might not be treaty protection. These entities may also be slapped with the need to prepare transfer pricing documentation etc.

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91 OECD/G20 Base Erosion and Profit Shifting Project, *Action 13: Country-by-Country Reporting Implementation package OECD BEPS*, executive summary.

92 Ibid, at para 4.

As a focus area, the authors would like to re-emphasize the need for related party definitions between the OECD MTC and domestic transfer pricing regimes to be aligned. Where proxies are used to identify related parties/associated enterprises, as in the case of the CbC Report, the fact that a constituent entity may not be an associated enterprise/related party for tax purposes should be highlighted by the OECD to the implementing jurisdictions to avoid unnecessary complications and compliance costs to MNEs.

6.5 "Closely related" concept under BEPS Action 7

The final report on preventing the artificial avoidance of permanent establishment status under BEPS Action 7, issued on 5 October 2015, recommended a number of changes to Article 5 of the OECD Model Convention including a tightening of the definition of an independent agent under Article 5(6).

Specifically, when a "person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related" that person cannot be considered an independent agent under Article 5(6) with respect to that enterprise. For this purpose, the recommendations provide that a person is "closely related" to an enterprise if, based on all the facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50% of the beneficial interest in the other (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company), or another person possesses directly or indirectly more than 50% of the beneficial interest (or, in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise.

We note that a "closely related" relationship as described in the preceding paragraph pertains to the identification of whether a person is an independent agent, and not to the definition of "associated enterprises" under Article 9 of the OECD Model Convention. However, this use of a control test and stating a beneficial interest threshold as indicative of a closely related relationship could arguably bring in new factors for consideration in determining relatedness, as jurisdictions consider how to define the scope of related parties in their transfer pricing regimes. It also remains to be seen if such a concept may eventually be adopted in other Articles of the OECD Model Convention.

7. Conclusion

In international taxation, it is important that jurisdictions interpret their bilateral treaties in the same manner. This will reduce or even prevent disputes arising from

different interpretation of the treaties. In respect of the topic of this paper, it is thus important that both jurisdictions adopt the same interpretation on the scope of associated enterprises. If one treaty partner were to read the term "associated enterprises" in a relatively restricted sense, while another country interprets the concept of "associated enterprises" in a broader sense, this may cause serious problems in the field of international taxation.[93]

The authors agree with the conclusion drawn by Dwarkasing that there is a need to provide more clarity on the meaning of the term "associated enterprise". This will facilitate interpretation and application of the associated enterprise article. The objective of elimination of economic double taxation will then be achieved. As expressed by the authors in earlier sections, Article 9 serves a specific purpose. It ensures that transactions between associated enterprises are conducted at arm's length. Adjustments can be made by the first jurisdiction to ensure this outcome. Where economic double taxation results, it also provides the mechanism for the other jurisdiction to make adjustments and remove the economic double taxation. The context envisaged is definitely that of parents and subsidiaries or subsidiaries in the same group, transacting with each other cross border. This generally served the original intention of Article 9 i.e. to provide for profit allocation.

Domestic TP legislation has a broader purpose. It is to ensure arm's length behaviour in both a domestic and cross border context. Every jurisdiction can exercise its sovereign right to set its own rules to meet its specific objectives. Logically, it would neither be possible nor realistic to align the purpose of Article 9 together with how associated enterprises are defined in domestic TP legislation. In a cross border context, the real issue would tend to arise in the context of parents and subsidiaries or subsidiaries in the same group, and less so of other types of association as defined under domestic legislation e.g. by blood etc. From the authors' perspective, while the domestic and international definitions of associated enterprises are not aligned, this would generally not be so critical. What matters is that countries interpret Article 9 and their obligation with consensus to ensure that the intended effect of the Article is achieved. That said, depending on the jurisdictions' interpretations of their obligations under Article 25 of the OECD MTC, the authors would agree with Dwarkasing and argue that jurisdictions would already have the duty or avenue to deal with cases of economic double taxation that arise. As mentioned in the commentary to Article 25(1)[94], whether or not the actions of one or both of the Contracting States will result in taxation not in accordance with the Convention must be determined from the perspective of the taxpayer. Where the domestic and international definitions of associated enterprises are not aligned, taxpayers may be in a situation where double taxation results. Consequently, an MAP for both states to resolve this difference can be triggered under Article 25(1). If both states subsequently take the position that

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[93] Dwarkasing op. cit, at pg. 6.

[94] OECD, op. cit., Commentary to Article 25 para 14

nothing can be done under Article 25(1) on the premise that it does not come under the scope of the OECD MTC based on their interpretation of the Articles in the OECD MTC, a case could be made under Article 25(3) for both states to try to resolve the double taxation even if both States regard that the situation falls out of the OECD MTC.[95] Nonetheless, the use of Article 25(3) to resolve such issues should be the exception more than the norm. The clarification of the scope of Article 9 should be the preferred solution.

Given the increasing focus on transfer pricing, it is anticipated that more transfer pricing disputes can be expected. With it, there would likely be greater use of Articles 9 and 25 to eliminate economic double taxation that may arise. This intensifies the need for clarity on the scope of Article 9. While the authors are convinced of the original intended scope of Article 9, it would also be timely to review the scope in light of the changes that would be made to the transfer pricing guidelines. The authors do not advocate expanding the scope of Article 9. However, some slight changes may be necessary to cater for the changes in business models and the way business is carried out between enterprises. As mentioned, the authors would reiterate and caution against the tendency to lump these changes with the solution for tax avoidance or evasion. These should be addressed separately and not be muddled with the scope of Article 9.

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[95] OECD, op. cit., Commentary to Article 25 para 55.

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Appendix 1

Summary of the definition of related parties / associated enterprises in the transfer pricing regime of selected jurisdictions[96]

Country	Definition of related parties / associated enterprises in the transfer pricing regime
Australia	The Australia transfer pricing regime is applicable if an Australian entity gets a transfer pricing benefit in Australia from cross-border conditions that are inconsistent with the arm's length principle. Where there is a relevant tax treaty to the cross border transaction, the Australia transfer pricing legislation makes reference to the Associated Enterprises Article of the tax treaty in determining if there is a transfer pricing benefit. However, note that there is a requirement to disclose 'international related parties' in the International dealings schedule 2016 (NAT 73345), which forms part of your entity's tax return. 'International related parties' means an interest in equity, voting rights, or income distribution of 20% or more. International related parties are persons who are not dealing wholly independently with one another in their commercial or financial relations and whose dealings or relations can be subject to Subdivision 815-B of the ITAA 1997 or the associated enterprises article of a relevant tax treaty. The term includes: • Any overseas entity or person who participates directly or indirectly in the person's management, control or capital; • Any overseas entity or person in respect of which the person participates directly or indirectly in the management, control or capital; or • Any overseas entity or person in respect of which persons who participate directly or indirectly in its management, control or capital are the same persons who participate directly or indirectly in the person's management, control or capital. (Source: Section 815.15 and Section 815.120, Income Tax Assessment Act 1997)
Belgium	Two parties are related if one of them participates directly or indirectly in the management, control or share capital of the other or if a third party or third parties participate directly or indirectly in the management, control or share capital of both parties. However, note that the Royal Decree of 10 August 2009 requires corporations to report non-arm's length transactions with related parties, making reference to the International Accounting Standard 24 for the definition of related parties. (Source: Article 26 of the Belgian Income Tax Code Royal Decree of 10 August 2009)
China	An enterprise is related to another enterprise, organization or individual if:

[96] Information provided in the summary table is based on the sources indicated as assessed on 1 July 2016.

	• One party holds directly or indirectly at least 25% shares of the other party, or a third party holds directly or indirectly at least 25% shares of both parties; • One party holds the shares of the other party through an intermediary, as long as that party holds at least 25% of the shares of the intermediary, the percentage by which that party holds the shares of the other party is the same as that of the intermediary's shareholding of the other party; • Two or more natural persons are related by marriage, lineage, are siblings and other financially dependent relations, and jointly hold shares of the same enterprise, their shareholding percentage are combined to determine the aggregate shareholding percentage; • The total debts owed by one party to the other party exceed 50% of either party's paid-up capital, or at least 10% of the total debts owed by one party is guaranteed by the other party, with the exception of an independent financial institution without a controlling relationship; • One party's operational activity is dependent on intangibles provided by the other party, e.g. patents, non-patented technology, trademarks, copyrights, etc.; • The purchases, sales, provision of services, receipt of services or other business activities are controlled by the other party, where control refers to the right of one party to make decisions on the other party's financial and operational strategies, so as to benefit from the other party's business operations; • More than half of one party's directors or senior management personnel, including a public listed company's secretary of the board, manager, deputy manager, finance chief or other personnel according to a company's articles of incorporation, are appointed or assigned by the other party, or who concurrently hold a directorship or senior management position of the other party; or two parties each with more than half of their directors or senior management personnel being appointed or assigned by the third party; • Where the relationship between two parties satisfies any one of the definitions stated in the points above, and so does the relationship between each party and another natural person that is related by marriage, lineage, sibling relationship or other financially dependent relationship; or • The two parties have other substantial common interests. (Source: Bulletin of the State Administration of Taxation [2016] No. 42)
Canada	Paragraph 251(1)(a) deems that related persons do not deal with each other at arm's length, regardless of how they actually conduct their mutual business transactions. • Individuals connected by blood relationship, marriage, common-law partnership or adoption; or • A corporation with another person where: (a) that person controls the corporation; (b) that person is a member of a related group that controls the corporation; or (c) that person is a person who is related to a person described in (a) or (b) above; or • Two corporations are related if: (i) the two corporations are controlled by the same person or group of persons; (ii) each of the corporations is controlled by one person and the person who controls one corporation is

	related to the person who controls the other corporation; (iii) one of the corporations is controlled by one person and that person is related to any member of a related group that controls the other corporation; (iv) one of the corporations is controlled by one person and that person is related to each member of an unrelated group that controls the other corporation; (v) any member of a related group that controls one of the corporations is related to each member of an unrelated group that controls the other corporation; or (vi) each member of an unrelated group that controls one of the corporations is related to at least one member of an unrelated group that controls the other corporation. (Source: Subsection 251(2) of the Income Tax Act)
France	Associated enterprises are those that depend on or control enterprises outside France. Dependence can be either de jure or de facto. Furthermore, there is no need to prove the relationship of dependence or control in respect of profit transfers to enterprises located in a foreign jurisdiction that has a preferential tax regime. There is de jure dependence if a French enterprise is dependent on a foreign enterprise through share capital or voting rights, or if the foreign enterprise has the authority to perform functions that include decision-making, either directly or indirectly through intermediaries. There is de facto dependence resulting from commercial relationships, e.g. dependence through personnel or equipment of the foreign enterprise. De facto dependence has been ruled in numerous case laws. (Source: Section 57 General Tax Code)
Germany	• A person holds, directly or indirectly, a participation of at least 25% in the other person's capital, or has direct or collateral possibility to exert a dominating influence to the related party; or • A 3rd person holds, directly or indirectly, a participation of at least 25% in both in that person's and the other person's capital, or exerts indirectly or collaterally a dominating influence. (Source: Section 1 paragraph 2 of the Foreign Tax Act (Außensteuergesetz))
India	Two enterprises are associated enterprises if: • One enterprise participates, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise; or • In respect of which one or more persons who participate, directly or indirectly, or through one or more intermediaries, in its management or control or capital, are the same persons who participate, directly or indirectly, or through one or more intermediaries, in the management or control or capital of the other enterprise. In addition, two enterprises are deemed associated enterprises if, at any time during the previous year: • One enterprise holds, directly or indirectly, shares carrying at least 26% of the voting power in the other enterprise;

	• Any person or enterprise holds, directly or indirectly, shares carrying at least 26% of the voting power in each of such enterprises; • A loan advanced by one enterprise to the other enterprise constitutes at least 51% of the book value of the total assets of the other enterprise; • One enterprise guarantees at least 10% of the total borrowings of the other enterprise; • More than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one enterprise, are appointed by the other enterprise; • More than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two enterprises are appointed by the same person or persons; • The manufacture or processing of goods or articles or business carried out by one enterprise is wholly dependent on the use of know-how, patents, copyrights, trademarks, licences, franchises or any other business or commercial rights of similar nature, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or in respect of which the other enterprise has exclusive rights; • At least 90% of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one enterprise, are supplied by the other enterprise, or by persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise; • The goods or articles manufactured or processed by one enterprise, are sold to the other enterprise or to persons specified by the other enterprise, and the prices and other conditions relating thereto are influenced by such other enterprise; • Where one enterprise is controlled by an individual, the other enterprise is also controlled by such individual or his relative or jointly by such individual and relative of such individual; • Where one enterprise is controlled by a Hindu undivided family, the other enterprise is controlled by a member of such Hindu undivided family or by a relative of a member of such Hindu undivided family or jointly by such member and his relative; • Where one enterprise is a firm, association of persons or body of individuals, the other enterprise holds at least 10% interest in such firm, association of persons or body of individuals; or • There exists between the two enterprises, any relationship of mutual interest, as may be prescribed. (Source: Section 92A, Chapter X, Income Tax Act 1961)
Indonesia	Related parties are deemed to exist: • Where a taxpayer directly or indirectly participates in at least 25% of the capital of another taxpayer; • Where a company participates in at least 25% of the capital of two taxpayers, in which case the latter two taxpayers are also considered to be related; • Where a taxpayer directly or indirectly controls another taxpayer or where two or more taxpayers are under common control; or • Where there is a family relationship by blood or marriage.

	(Source: Article 18 Income Tax Law)
Ireland	Two persons are associated if one person participates in the management, control or capital of the other person, or if a third person participates in the management, control or capital of each of the two persons. A person is deemed to be participating in the management, control or capital of another person if that other person is a company and is controlled by the first person. A company is treated as controlled by an individual if it is controlled by the individual and persons connected with the individual, i.e. a relative of that individual. (Source: Section 835B of the Taxes Consolidation Act 1997 (as inserted by Section 42 of the Finance Act 2010))

Japan	A foreign-related person is a foreign corporation that has:
	• At least 50% holding in the total number of issued shares or amount of investment; or
	• A special relationship, which includes situations where:
	    o 50% or more of the officers of the company are or were employees or officers of the other company
	    o The representative director of the company is or was an employee or officer of the other company;
	    o A considerable proportion of a company's operating transactions are with the other company; or
	    o A considerable proportion of a company's outstanding loans, which are necessary to the company's operations, have been borrowed from or guaranteed by the other company.
	
	(Source: Article 39-12 Cabinet Order on the Special Taxation Measures Law)

Luxembourg	When an enterprise participates, directly or indirectly, in the management, control or capital of another enterprise, or where the same individuals participate, directly or indirectly, in the management, control or capital of two enterprises and where, in either instance, the two enterprises are, within their commercial or financial relations subject to conditions made or imposed which differ from those which would be made between independent enterprises, the profits of these enterprises are to be determined under conditions prevailing between independent enterprises and taxed in consequence. (Source: Article 56 Luxembourg Income Tax Law)
Malaysia	Where a corporation – • Is the holding company of another corporation; • Is a subsidiary of another corporation; or • Is a subsidiary of the holding company of another corporation, The corporation and that other corporation are deemed to be related. Where – • Two or more companies are related within the meaning above; • A company is so related to another company which is itself so related to a third company; • The same persons hold more than 50% of the shares in each of two or more companies; or • Each of two or more companies is so related to at least one of two or more companies that the preceding point applies,

<table>
<tr><td></td><td>all the companies in question are considered the same group.

(Source: Companies Act 1965, Section 6
Income Tax Act 1967, Subsection 2(4))</td></tr>
<tr><td>Netherlands</td><td>• Where an entity participates, directly or indirectly, in the management, control or capital of another entity, and conditions are made or imposed between these entities in their commercial and financial relations (transfer prices) which differ from conditions which would be made between independent parties, the profit of these entities will be determined as if the last mentioned conditions were made.
• The paragraph above will also be applicable, when the same person participates, directly or indirectly, in the management, control or capital of both the first and second entity.

(Source: Article 8b, paragraph 1 Wet op de Vennootschapsbelasting 1969 (Corporate Income Tax Law))</td></tr>
<tr><td>New Zealand</td><td>The definition of associated persons in New Zealand’s Income Tax Act is extensively worded and includes relationships between companies, between a company and a person other than a company, between two relatives, etc. The definition is applied for the purposes of the whole Act unless specifically stated otherwise, i.e. it is applied under New Zealand’s transfer pricing regime.

In the case of companies, two companies are considered associated if:
• A group of persons exists whose total voting interests in each company are 50% or more;
• a market value circumstance exists for either company; and a group of persons exists whose total market value interests in each company are 50% or more; or
• A group of persons exists who control both companies by any other means.

(Source: Section YB, Income Tax Act 2007 No 97)</td></tr>
<tr><td>Singapore</td><td>A related party, in relation to a person, means any other person who, directly or indirectly, controls that person, or is controlled, directly or indirectly, by that person, or where he and that other person, directly or indirectly, are under the control of a common person.

(Source: Section 13(16) Income Tax Act)</td></tr>
<tr><td>South Korea</td><td>• Either party to a transaction owns directly or indirectly at least 50% of the voting shares (including the equity shares; hereinafter the same shall apply) of the other party;
• Both parties to a transaction, where a third party owns directly or indirectly at least 50% of their respective voting shares;
• Parties to a transaction have common interests through an investment in capital, a transaction of goods or service, a grant of loan, etc. and either party to a transaction has power to actually make a decision on the business policy of the other party; or
• Both parties to a transaction, where the parties to the transaction have common interests through an investment in capital, a transaction of goods or service, a grant of loan, etc. and a third party has power to actually make a decision on the business policies of both parties.</td></tr>
</table>

	(Source: Article 2 International Tax Coordination Law)
Switzerland	Switzerland does not have specific transfer pricing legislation and adheres to the OECD's Transfer Pricing Guidelines including its updates. In an instruction issued on 4 March 1997, the Director of the Swiss Federal Tax Administration informed the cantonal tax authorities about the OECD Transfer Pricing Guidelines and asked that the guidelines are observed when adjusting profits or when assessing multinational enterprises in the respective canton.
Thailand	"Associated companies or juristic partnerships" means two or more companies or juristic partnerships having any of the following relationships: • More than one half of the same shareholders or partners in a juristic person constitutes more than a half of the number of the shareholders or partners in another juristic person; • The shareholders or partners holding more than 50% of the value of the total capital of a juristic person are also the shareholders or partners holding more than 50% of the value of the total capital of another juristic person; • A juristic person is a shareholder or partner holding more than 50% of the value of the total capital of another juristic person; or • Persons constituting more than one half of the number of the directors or partners controls the management of a juristic person and are also directors or partners who control the management of another juristic person. (Source: Section 38_64 Revenue Code)
United Kingdom	The "participation condition" is met, namely: • One party directly or indirectly participates in the management, control or capital of the other, or a 3rd party participates in the management, control capital of the two parties; or • 40% test of control for joint ventures; or • Persons acting together to exert control in relation to financing arrangements. (Source: Taxation (International and Other Provisions) Act 2010, Part 4 Corporation Tax Act 2010, Section 1124)

United States	• Any 25% foreign shareholder of the reporting corporation;
	• Any person who is related to the reporting corporation or to a 25% foreign shareholder of the reporting corporation. In this regard, the Act includes the following situations as relatedness:
	   o Members of a family, as defined in subsection;
	   o An individual and a corporation more than 50% in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;
	   o Two corporations which are members of the same controlled group;
	   o A grantor and a fiduciary of any trust;
	   o A fiduciary of a trust and a fiduciary of another trust, if the same person is a grantor of both trusts;
	   o fiduciary of a trust and a beneficiary of such trust;
	   o A fiduciary of a trust and a beneficiary of another trust, if the same person is a grantor of both trusts;

	○ A fiduciary of a trust and a corporation more than 50% in value of the outstanding stock of which is owned, directly or indirectly, by or for the trust or by or for a person who is a grantor of the trust; ○ A person and an organization to which section 501 (relating to certain educational and charitable organizations exempt from tax) applies and which is controlled directly or indirectly by such person or, if such person is an individual, by members of the family of such individual; ○ A corporation and a partnership if the same persons own - (A) more than 50 percent in value of the outstanding stock of the corporation, and (B) more than 50% of the capital interest, or the profits interest, in the partnership; ○ An S corporation and another S corporation if the same persons own more than 50% in value of the outstanding stock of each corporation; ○ An S corporation and a C corporation, if the same persons own more than 50% in value of the outstanding stock of each corporation; or ○ Except in the case of a sale or exchange in satisfaction of a pecuniary bequest, an executor of an estate and a beneficiary of such estate; or • Any other person who is related within the meaning of section 482 to the reporting corporation. Section 482 describes the case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests. (Source: Section 6038A Internal Revenue Code Section 267B Internal Revenue Code Section 482 Internal Revenue Code)
Vietnam	Parties shall be considered parties having associated relations (below collective) referred to as associated parties in any of the following cases: • One party directly or indirectly participates in the management or control of, contribution of capital to or investment in any form in the other party; • The parties are directly or indirectly subject to the management or control of, contribution of capital to, or investment in any form, by another party; or • The parties directly or indirectly participate in the management or control of, contribution of capital to, or investment in any form in another party. Normally, two enterprises shall be considered associated in a tax period if during such period: • One enterprise directly or indirectly holds at least 20% of investment capital of the other enterprise; • A third party directly or indirectly holds at least 20% of investment capital of both enterprises; • Both enterprises directly or indirectly hold at least 20% of investment capital of a third party; • One enterprise is the biggest shareholder regarding investment capital of the other enterprise, directly or indirectly holding at least 10% of investment capital of the other enterprise; • One enterprise guarantees or gives to the other enterprise loans in any form on the condition that such loans account for at least 20% of investment capital of the borrowing enterprise and account for over 50% of

	the total value of medium term and long term loans of the borrowing enterprise; • More than 50% of total members of the board of executive directors or total members of the control board of one enterprise are appointed by the other enterprise or one executive director or one member of the control board of one enterprise who has power to decide on financial policies or business activities of the other enterprise is appointed by the other enterprise; • More than 50% of members of the board of directors or a member of the board of directors who has power to decide on financial policies or business activities of each of the two enterprises are appointed by the same third party; • The two enterprises are managed or controlled in personnel, financial and business affairs by individuals being members of a family who have relations of husband and wife, parent and child (whether natural, adopted children or children-in law); siblings of the same parent (whether natural or adoptive parent), grandparent and grandchild of the same blood line, aunt or uncle and niece or nephew of the same blood line; • The two enterprises have the relationship of head office and resident establishment or are resident establishments of the same foreign organization or individual; • One enterprise manufactures or trades in products using intangible assets and/or intellectual property rights of the other enterprise for which it has to make a payment accounting for over 50% of historical cost (or cost price) of such products; • Over 50% of the total value of raw materials, materials, supplies or input products (exclusive of fixed asset depreciation expenses) used by one enterprise for manufacturing or trading in output products are supplied by the other enterprise; • Over 50% of products (calculated for each kind of product) sold by one enterprise is directly or indirectly controlled by the other enterprise; or • The two enterprises have reached a business cooperation agreement on a contractual basis. (Source: Circular 66/2010/TT-BTC)