# Transactional Adjustments in Transfer Pricing

IBFD DOCTORAL SERIES 40

# Transactional Adjustments in Transfer Pricing

**Why this book?**
This book examines whether, and to what extent, transactional adjustments may be applied within transfer pricing, i.e. whether it is possible to alter conditions and circumstances (other than prices or margins) of transactions conducted between related parties. In the context of the comparability analysis demanded by transfer pricing rules, the conditions and circumstances of controlled transactions normally serve to define the magnitude of its identity with an uncontrolled comparable reference, to determine if primary adjustments on profits need to be implemented. Nevertheless, it is relevant to question whether these very factors could also be subject to adjustments, since altering the features of controlled transactions, such as the attribution of risks, the re-allocation of intangible assets or even the entire disregarding of a loan transaction, will undoubtedly have an impact on the profits of the assessed entity. In this book, it is shown that transactional adjustments are not only possible but also inherent to the arm's length principle. However, a clear and precise delineation of stringent boundaries, both in the scope and the manner in which adjustments are to be applied, is essential to mitigate undue discretion. Through the examination of such limits, defined in accordance with the arm's length principle, a model on the enforcement of transactional adjustments is proposed. This model is of interest not only for determining the proper implementation of the referred adjustments, but also to duly assess the appropriateness of their treatment in different frameworks, ranging from parameters defined in the Transfer Pricing Guidelines and BEPS actions referring to transfer pricing, to domestic transfer pricing rules and court decisions. Furthermore, the impact of transactional adjustments on specific scenarios that practitioners, tax administrations and courts have to face regularly within the realm of transfer pricing is thoroughly examined – namely, on the distribution of risks, the attribution of profits generated by intangible assets, the assessment of hard-to-value intangibles, business restructurings and cost sharing agreements.

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# Preface

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As reflected in the 2017 IFA Congress discussions, transfer pricing is one of the most controversial topics in international taxation. This makes perfect sense if one takes into account that such a subject results from the combination of a broad standard like the arm's length principle and some extraordinary detailed guidelines such as those elaborated by the OECD. Even without considering its rationale as a tool embedded in double tax convention (DTC) provisions equivalent to article 9 of the OECD Model Tax Convention (OECD MTC) for allocating income, it seems obvious that the content of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TPG) is exuberant, and even excessive. In fact, a principle or a standard does not demand a determinate decision, but instead states a rationale or a guideline that must be taken into account to reach a decision,[1] and one must therefore be bound by its content in order to achieve an appropriate outcome in a given case. Here lies the complexity of transfer pricing regulations. As Aitor Navarro states in this book, the arm's length principle is not confronted with any other principle, but with reality itself, a rather complex and changing one. It is hardly possible to find the proper treatment from a standard that, due to its very nature, provides guidance for the interpretation of other rules instead of accurate solutions for a specific course of action. While it is true that principles are at times the sole ground upon which to reach a decision in a particular case (seeing as what ought to be done from a legal perspective is determined directly by the application of one or several principles),[2] it is also worth emphasizing that this is not normally the case in the context of tax law; in this field, as a result of the importance of the rule of law principle and the need for certainty, that outcome must be considered exceptional.

Taking into consideration that the arm's length standard is limited to providing a guidance of result, it should be obvious that there is a need to introduce transfer pricing rules that concretize the standard for providing more specific regulations in order to reduce the discretion of the tax authorities and to give courts an appropriate framework of control. At this time, the OECD

1. R. Dworkin, *Taking Rights Seriously*, pp. 22 et seq. (Harvard Univ. Press, 1977).
2. J. Raz, *Legal Principles and the Limits of Law*, Yale Law Journal 81, pp. 841-842 (1972).

TPG do not constitute a legally satisfactory response capable of providing minimum certainty for multinational groups (at least not in all jurisdictions). Indeed, the debate surrounding the role that the OECD TPG should play as a soft law instrument – even when these are assumed by domestic jurisdictions for interpretative purposes[3] – often results in issues arising from the fact that tax authorities tend to employ the guidelines in a straightforward manner, without considering whether their content is in accordance with the arm's length principle rationale. This disparity unfortunately occurs more frequently than is desirable.

A preface is not the appropriate place to critically examine the foundations of the arm's length principle, but it must be stressed that a thorough analysis may prove that this standard may not be as robust as it appears to be at first sight,[4] especially in what concerns one of the most relevant aspects of this book: the comparability of transactions. A number of issues arise from the fact that transfer pricing rules have their origins in a fallacy, according to which "transactions among unrelated parties can be found that are sufficiently comparable to transactions among members of multinational groups".[5] For this reason, it becomes evident that, from a juridical point of view, there is a need for a reconsideration of the meaning of a comparability analysis, the factors to be considered in this respect and the adjustments to be undertaken so as to apply the arm's length standard correctly.

In this regard, works like this undertaken by Aitor Navarro must be praised, seeing as not only the technical details of a specific aspect within the transfer pricing sphere should be assessed, but also its very foundation, i.e. the nature and meaning of the arm's length principle from a legal – and even a constitutional – viewpoint.[6] This becomes even more relevant when – as is

3. This is the case in Spain, which the Corporate Income Tax Law (*Ley del Impuesto sobre Sociedades*) of 27 Nov. 2014 affirms in its preamble: "[T]he interpretation of such a [transfer pricing] provision related to such [controlled] transactions must be performed precisely in accordance with the OECD Transfer Pricing Guidelines and the recommendations of the EU Joint Transfer Pricing Forum, as long as these do not contradict the wording of the provisions, or that of the regulations related to it" (unofficial translation).
4. S.A. Rocha, *The future of transfer pricing: General Report*, pp. 107 et seq. (IFA Cahiers vol. 102B, 2017).
5. R. Avi-Yonah, *Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation*, 2 World Tax J. 2, p. 8 (2010).
6. Prof. Luis Schoueri is the scholar who has dealt the most with the relevance of constitutional principles – in particular the ability-to-pay principle – to the interpretation of the arm's length principle; *see*, for example, L.E. Schoueri, *Preços de transferencia no Direito Tributario brasileiro* 3rd ed., par. 1.3. (Dialetica 2006) and L.E. Schoueri, *Arm's Length: Beyond the Guidelines of the OECD*, 69 Bull. Intl. Taxn. 12, pp. 695 et seq. (2015), Journals IBFD.

the case with this book – the analysis is balanced, both in the examination of the arm's length principle and the study of the specifics of transfer pricing regulations. This is best done, as Aitor Navarro demonstrates, without getting lost in the technicalities of a document (in this case, the OECD TPG) that, due to its structure and features, may sometimes be more far-reaching than desirable.

This work undertaken by Aitor Navarro is especially valuable because it strives to build a framework for the application of transactional adjustments by specifying the limits derived from DTCs containing a clause similar to that of article 9 of the OECD MTC through the content of the OECD TPG, to which he attributes an appropriate role in the interpretative process. An effort that is particularly relevant in Spain, in which the decision of the Supreme Court on 18 July 2012 in *BICC* (rec. 3779/2008) gave the tax authorities carte blanche to perform the necessary adjustments to neutralize any tax outcome derived from financial transactions that could entail a reduction of the taxable base of controlled entities, without even considering the need to find comparables. It is true that the decision of the Supreme Court on 31 May 2016 in *Peugeot* (rec. 58/2015) amended many of the mistakes of the *BICC* doctrine; it declared that it is unacceptable for tax authorities to use transfer pricing rules without taking the effort to look for comparable references and that the use of article 9 of the applicable DTCs does not constitute by itself – not even in connection with the OECD TPG – a valid legal foundation to disregard the conditions of a controlled transaction,[7] because such authority should be drawn from domestic law.[8] Nevertheless, despite that the *Peugeot* decision overcame the poorly built reasoning posed in *BICC*, the tax administration continues to base their assessments on this odd kind of adjustment without any sign of exhaustiveness whatsoever. This was illustrated in the recent decision of the Spanish Central Economic-Administrative Court (*Tribunal Económico-Administrativo Central*) of 11 September 2017 in *Avanza* (RG 996-14 and 5881-14), in which the deduction of interests paid resulting from a participating loan granted by a related entity in the context of a debt push-down structure was disregarded. This was because – according to the tax authorities – the agreed conditions

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7. A. Navarro, *El desconocimiento de operaciones vinculadas en el ámbito de los convenios para evitar la doble imposición: Una crítica a la doctrina vertida por la Audiencia Nacional y el Tribunal Supremo*, Quincena Fiscal 11 (2017).
8. F.A. García Prats, *Artículo 9: Empresas Asociadas*, in *Comentarios a los convenios para evitar la doble imposición y prevenir la evasión fiscal concluidos por España*, p. 551 (J.R. Ruíz García and J.M. Calderón Carrero eds., Fundación Pedro Barrié de la Maza 2005).

could not have been replicated in the open market, as independent parties would not have agreed to such terms.

This book by Aitor Navarro, based on a thesis that was awarded summa cum laude at Carlos III University in Madrid, is particularly valuable, as it contains a proposal for a methodology on how to properly apply transactional adjustments. The adopted approach becomes relevant once it is ascertained that the criteria posed in the OECD TPG are inadequate, a fact that necessitates the construction of an intermediate set of rules that guarantee the correct application of the arm's length principle to an increasingly complex reality. The increasing digitalization of the economy most likely will enhance the differences in the functioning of multinational enterprises (MNEs), which are gradually deviating more from that of independent enterprises, hampering the achievement of the arm's length principle. In particular, it is important that specific rules are enacted to precisely determine the effects of the recharacterization of controlled transactions, either to confine them to the realm of transfer pricing or to allow their effects to extend beyond this area. Due to the fact that transactional adjustments are aimed at reconfiguring certain conditions of a transaction so as to better perform a comparability analysis, it is clear that the fiction derived from their application generates an effect exclusively in this field, i.e. in the ascertainment of a proper valuation adjustment. Nonetheless, such an aim is not as evident as it should be when – always exceptionally, as Aitor Navarro sustains – the tax authorities are faced with the impossibility to find comparables and therefore disregard a transaction. In this case, the effects of such adjustments should be specified. In particular, it should be determined whether the outcome of transactional adjustments impacts only transfer pricing adjustments or could be extended beyond this field in order to assess the determination of corporate taxes due in general terms. This issue has already been posed in the context of the enforcement of general anti-abuse rules (GAARs), and, in parallel with the solution expressed by the author of this preface in this regard,[9] it seems logical that the implementation of transactional adjustments should generate effects only for certain taxes and transactions and therefore should not involve other possible arrangements and taxes. If the objective of the legislator would be to provide for a far-reaching fiction, such an aim should be explicitly declared, as happens, for example, in cases of secondary adjustments derived from transfer pricing rules. Notwithstanding this, when it comes to a complex artificial set of transactions, the avoidance of collateral effects seems difficult. This may

9. A. Báez Moreno and J. Zornoza Pérez, *Chapter 33: Spain*, in *GAARs – A Key Element of Tax Systems in the Post-BEPS World*, pp. 667-669 (M. Lang et al., IBFD 2016).

be inferred from the outcome of the decision of the Spanish National Court (*Audiencia Nacional*) on 21 February 2013 in *Accenture* (rec. 47/2010), in which the necessity of additional adjustments for other taxes and taxpayers seemed evident in order to avoid undesirable double taxation, especially in cross-border transactions in which the effects of the disregard of the transaction did not need to be accepted by third countries.

In any case, the truth is that changes in the structure and performance of MNEs – enhanced by the progressive digitalization of the distribution of goods and the performance of services – results in an ever-increasing differentiation when compared with the performance of independent enterprises. This state of affairs clearly demands an in-depth deliberation on the future of such a standard and its practical effectiveness. In this regard, it has been rightfully pointed out that the future of transfer pricing rules depends on the possibility to bridge the gap between the economic reality of MNEs and the requirement to price these economic relations with reference to situations in the open market.[10] If one adopts such a perspective, it is more than doubtful that transfer pricing-related outcomes derived from the BEPS Project could bring about a renovated vision of the arm's length principle.[11] This is because the attempts by the OECD to preserve the use of such a principle as a valid proxy for the allocation of business profits within MNEs give rise to certain doubts arising from its complex interaction with the intent of aligning profit allocation, value creation and real economic activity, especially since the OECD explicitly rejects an outright formulary apportionment of group profits according to certain factors.[12]

Transfer pricing rules are definitely at a crossroads, as it is not easy to foresee their future evolution in a framework that is still developing itself, due to the uncertainty of the final outcome of the BEPS Project and states' reactions during the process. The attempts to limit the weight of contractual arrangements, funding and ownership, which formed the basis of the traditional way in which the arm's length standard is applied, may entail a growth of legal uncertainty that could contribute to the unpredictability of the outcome of transfer pricing rules. Here lies the appropriateness of the analysis performed by Aitor Navarro, characterized by remarkable meticulousness and a well-grounded argumentation based on legal principles that

10. H. Förster and M. Guillou, *The Future of Transfer Pricing: EU Report*, p. 271 (IFA Cahiers vol. 102, 2017).
11. S.A. Rocha, *The Future of Transfer Pricing: General Report*, p. 198 (IFA Cahiers vol. 102, 2017).
12. W. Schön, *Transfer Pricing Issues of BEPS in the Light of EU Law*, British Tax Review 3, p. 419 (2015).

must be always present in the decision-making processes in the attempt to achieve a fair allocation of profits between controlled entities. The goal of this would be to avoid an increase in the discretionary powers of tax authorities, the performance of which must be subject to the rule of law, even in a field as specific and peculiar as transfer pricing is.

# Introduction

In the field of corporate taxation, the arm's length principle determines the need to adjust the profits of related parties derived from controlled transactions to reflect the outcome that independent parties would have agreed upon had a community of interests not existed. The adjustment is made by comparing prices, margins or profits derived from a controlled transaction and a suitable comparable uncontrolled reference, with the conditions and the circumstances of the transaction being the elements that define the degree of similarity in the comparison.

This notion synthesizes the rationale of transfer pricing rules drafted in accordance with the arm's length principle. In any case, an alternative would be to modify the conditions of the transaction itself, e.g. the bearing of risks, the attribution of intangible assets or even the complete disregarding of a loan transaction, as they impact prices or margins. However, such adjustments could lead to an undesirable amount of discretion, as comparability depends on the features of the controlled transaction and, on top of that, there are multiple ways to structure a transaction in order to reach a business goal.

It is therefore worth asking whether the arm's length principle actually permits the adjustment of the conditions of controlled transactions and, if so, which limits should be respected in order to comply with that principle. These two questions define the scope and purpose of this book. To understand the position maintained by the author on the subject, it is worth providing a preliminary answer to these questions. It is indeed possible to adjust the conditions of a controlled transaction within the framework of the arm's length principle. Moreover, it will be maintained that the feasibility of "transactional adjustments" – the term used to designate the adjustment of conditions from now onwards – is essential for complying with the aim of transfer pricing rules. That being said, a clear and precise delineation of limits in both the scope and the manner in which adjustments will be determined is essential for reducing discretion. Through the examination of such limits, defined in accordance with the arm's length principle, a model on the enforcement of transactional adjustments will be proposed. This model will be of interest for determining the proper implementation of such adjustments and for adequately criticizing their inappropriate use in different scenarios, for example the drafting of recommendations by the OECD on the issue, domestic regulations and court decisions.

The relevance of the topic is obvious due to the absence of adequate criteria on the matter. At the supranational level, the 2010 OECD Transfer Pricing Guidelines (TPG) pose certain recommendations on how to implement transactional adjustments; even so, ambiguity and dispersion render them inappropriate. Aside from that, transactional adjustments have been one of the most controversial issues discussed in the framework of the base erosion and profit shifting (BEPS) Project, sponsored by the OECD and the G20 countries to establish guidelines against base erosion and profit shifting.[1] These documents, the content of which was transposed into the 2017 edition of the OECD TPG, resulted in a complete redefinition of the criteria for adjusting the structure of controlled transactions in the framework of transfer pricing, albeit not always in an adequate manner, since, at the end of the day, the aim of this endeavour collides in many aspects with a proper understanding of the arm's length principle. The reader may notice that numerous friction points are pinpointed throughout this book, which is the main reason to affirm the pertinence of a thorough, systematic examination of the subject matter.

At the domestic level, the treatment of the issue is uneven. While certain jurisdictions have adopted the content of the OECD TPG, in others, case law has defined the parameters of how to conduct transactional adjustments, while a third group of countries has not yet dealt with this issue. Additionally, confusion has resulted from the comparison of this concept with other concepts such as secondary adjustments, thin capitalization rules and general anti-abuse rules, being a strong motive for a thorough, systematic examination of the mentioned subject matter.

This book analyses the definition of the scope and effects of transactional adjustments through the interpretation of the arm's length principle, and thus a *de lege lata* perspective is adopted. Such a profit attribution standard is present in many jurisdictions and, as a consequence, the proposed model of analysis will be pertinent to solving issues in every domestic tax system that includes transfer pricing rules drafted in accordance with the arm's length criterion. Therefore, no *de lege ferenda* measures are needed for the model proposal to be applicable, as it is derived directly from an adequate understanding of the arm's length principle. This mandate imposes limits on the adjustment of conditions of controlled transactions in both domestic and tax treaty law. On the one hand, if regulations[2] go against laws based

1. *See* OECD (2013), *Addressing Base Erosion and Profit Shifting*; and OECD (2013), *Action Plan on Base Erosion and Profit Shifting*.
2. The term "regulations" in this context has to be understood as equivalent to rules that are in a category below laws enacted by a representative body.

on the arm's length principle, they will be invalid. On the other hand, if domestic law rules go against this standard in the framework of a Double Tax Convention (DTC) that includes a clause identical to the one present in article 9 of the OECD Model Tax Convention (MTC), they will also not be applied, because such provisions act as a barrier impacting adjustments based on the domestic law of the contracting states.

The point of departure in the analysis will be the criteria posed in the OECD TPG, the purpose of which is both to define criteria regarding the arm's length principle for states to adopt in their domestic tax systems and to serve as a solid interpretational reference for article 9 of the OECD MTC. The use of soft law documents, mainly the OECD TPG and BEPS drafts and reports, will be of critical importance in the analysis of transactional adjustments. It is therefore necessary to determine the motives that justify the adoption of a point of departure based on such materials.

First, the content of these documents is based on the arm's length principle, acknowledged as a standard in many jurisdictions from different legal traditions. The standardization of this parameter and its adoption in almost every tax jurisdiction around the world – despite the difficulties in its implementation – is certainly a worthy accomplishment on the part of the OECD.

To continue, the OECD TPG serve as a model not only for defining the content of the arm's length principle but also as a blueprint for states when drafting transfer pricing rules based on that standard. In fact, not only do jurisdictions such as Australia, Canada and Spain make references to the content of the OECD TPG in their domestic laws but their case law on the subject also applies these soft law texts as if they were hard law.[3] In addition, both the OECD TPG and BEPS documents refer to the arm's length principle, and these are of great support to tax administrations and taxpayers, who normally base the content of transfer pricing documentation filings and tax audits on these materials.

Furthermore, the study of abstract patterns as posed in soft law texts proves useful, as they are not attached to the regulations of a single jurisdiction. As a result, conclusions reached in this book will be relevant in any jurisdiction that adopts the "at arm's length" parameter as a reference for attributing profits to controlled entities.

3. In sec. 2.3., the issue will be analysed in depth.

However, none of these considerations will interfere with a thorough critical analysis of the content of these soft law documents. Indeed, once it is ascertained that the parameters presented in these materials are not suitable for correctly defining a framework in which transactional adjustments may be applied in accordance with the arm's length principle, a model for properly achieving such a goal will be defined.

In addition, references to the OECD TPG will be combined with references to the domestic law of different jurisdictions and the relevant case law. Therefore, this book will not focus on a systematic comparative examination of tax law content in different jurisdictions, but will rather refer to aspects of domestic tax law as a tool for illustrating the relevant issues, revolving mainly – but not exclusively – around four specific jurisdictions.

The first jurisdiction is Spain, due to the author's knowledge of its domestic tax system and especially because of the growth in the number of cases in which Spanish courts have applied transactional adjustments in an incorrect manner. Moreover, the fact that explicit guidance on the subject does not exist at the domestic law level raises additional issues that will be addressed.

The second jurisdiction is the United States, as this country probably has the most advanced transfer pricing regulations in the world. These regulations have been the basis on which the OECD drafted the OECD TPG in many aspects, which is exemplified by the fact that their content is in some places identical. Aside from that, US courts have repeatedly dealt with the issue of transactional adjustments, being the first ones to raise the issue in the seminal cases *Koppers*[4] and *Seminole Flavor*[5] in the 1940s. Furthermore, the fact that OECD TPG guidance on transactional adjustments is quite similar to that of US regulations and case law is a strong reason to pay special attention to its content.

The third and fourth jurisdictions are Australia and Canada. They are mentioned together because the reason for the examination of their domestic law is identical. In both jurisdictions, an explicit reference to the adjustment of the conditions of controlled transactions is included in their domestic transfer pricing rules. This factor makes both jurisdictions quite attractive for the purposes of this book, since there are almost no other jurisdictions that specifically recognize the authority to undertake transactional adjustments in their domestic law.

4. *Koppers Company v. Commissioner* (1943, Tax Court, United States).
5. *Seminole Flavor Co. v. Commissioner* (1945, Tax Court, United States).

With regard to the scope of this book, several parameters should be precisely defined. First, the book focuses on transactional adjustments in the context of the arm's length principle from a tax law perspective. Considerations that could impact other fields of law or other fields of knowledge in the social sciences, such as economics or business administration, are excluded.

Second, in the field of tax law, attention will be paid exclusively to corporate income taxes. The influence of the arm's length principle in the context of income taxes on individuals or indirect taxes and issues related to the attribution of income to permanent establishments will not be addressed, mainly because the non-existence of contracts as a point of departure for the analysis implies that the adjustment of the conditions of transactions is completely irrelevant in this field. This is because such transactions (usually referred to as "dealings") constitute a fiction (valuation according to the arm's length principle rationale) built upon another fiction (the consideration of a permanent establishment as a functionally separate entity), which entails regarding the PE as being separate from the rest of the enterprise. As these fictions are based on an economic functional analysis, transactional adjustments are senseless. The only exception would be the alteration of facts that have actually occurred in a given case.[6]

Third, within the framework of transfer pricing rules, issues related to their subjective scope will not be scrutinized.[7] To examine transactional adjustments, it is necessary for one to assume that a transaction falls within the scope of transfer pricing regulations; otherwise, issues derived from their examination would not arise at all.

The absence of references to correlative adjustments is justified by the absence of specific issues related to the elimination of economic double taxation through such a tool; that is to say, transactional adjustments in accordance with the arm's length principle should be considered pertinent when determining the amount to be adjusted in the state of residence of the counterpart. Disputes over the appropriateness of adjustments to conditions should be resolved by resorting to mutual agreement procedures or equivalent means of conflict resolution.

Fourth, the impact of the arm's length principle in the context of EU law will not be addressed, since no parameters on transactional adjustments have

6. In such a scenario, considerations posed in sec. 3.1. may be of relevance.
7. The delineation of the subjective scope of transfer pricing rules is different in each jurisdiction. The OECD does not provide guidance in this regard. *See* DWARKASING (2011), pp.174-175.

been dealt under its aegis, neither from a positive perspective (especially as with the EU Arbitration Convention, 90/436/EEC, on the elimination of double taxation in connection with the adjustment of profits of associated enterprises)[8] nor under the Court of Justice of the European Union (CJEU) case law on direct taxation and the fundamental freedoms. That said, it is relevant to emphasize that the model proposal contained in this book can be extrapolated to both fields, as it derives from the interpretation of the arm's length principle itself, a concept present in both the EU Arbitration Convention and CJEU case law. In other words, transactional adjustments do not entail issues in EU law other than those regarding their fit with the arm's length principle; therefore, if these adjustments are performed in accordance with that standard, no further conflicts should arise in an EU setting.

The book is divided into two parts, the first of which regards the framework of the application of transactional adjustments. In chapter 1, fundamental aspects of the functioning of transfer pricing rules will be addressed as a guideline in order to understand the implication of specific issues that will arise throughout the analysis. In addition, questions related to the nature and aim of the arm's length principle will be examined, because this parameter will serve as a point of departure for defining the scope and content of the alteration of the conditions of controlled transactions. Thereafter, the definition of the concept of "transactional adjustments" will be analysed, alongside its origins and the current OECD position on the subject. In chapter 2, the normative framework in which transactional adjustments are appropriate will be addressed. The limits derived from DTCs containing a clause similar to that of article 9 of the OECD MTC will be scrutinized, along with domestic law that establishes the legal basis for the enforcement of the arm's length principle and transactional adjustments. The relevance of the OECD TPG in the interpretative process of transfer pricing rules will also be addressed.

The second part of the book contains a model proposal for how to properly apply transactional adjustments. In chapter 3, the adequate delineation of the relevant facts as the first essential step of the comparability analysis will be determined. In chapter 4, the scope and consequences of transactional adjustments as defined by the OECD will be analysed. Once it is ascertained that the criteria posed in the OECD TPG are inadequate, a model proposal will be constructed. In the chapter 5, the model proposal will be applied to those areas in which transactional adjustments may play a role,

8. Official Journal of the European Communities no. L 225, 20 Aug.1990, pp. 10-24.

so as to measure it against specific transfer pricing practical issues, namely risk allocation, the attribution of profits generated by intangible assets, the assessment of hard-to-value intangibles, business restructurings and cost sharing agreements (CSAs).

Conclusions will be compiled in the last pages of the analysis and at the end of each chapter. The collection of conclusions in a single section will provide a convenient overall view of the thesis. Sections within which arguments supporting each conclusion are developed will be cited within brackets to facilitate their tracking.

It is also worth clarifying certain formal aspects related to the terminology employed. First, it may be noticed that the terms "arm's length principle", "arm's length standard", "standard 'at arm's length'" and "arm's length parameter" are used as synonyms for a single notion, which is the arm's length criterion, relevant for the allocation of profits between related parties in order to compute their taxable income;[9] the meaning of each of these expressions is thus intended to be identical. Second, the term "transfer pricing rules" is to be understood as rules based on the arm's length principle that develop and implement that standard in DTCs and domestic law, at the level of both the law and regulations-based rules, in line with the concept elaborated by the vast majority of the worldwide scholarly literature.[10] Third, the terms "transactional adjustments" and "structural adjustments" will be used as synonyms, referring to adjustments of the conditions of a controlled transaction undertaken in the context of transfer pricing rules based on the arm's length principle. Lastly, the OECD Transfer Pricing Guidelines will be referred to by the acronym TPG accompanied with the year of publication, e.g. the 2017 version will be cited as "OECD TPG17".

9. *See* BRAUNER (2016), p. 108; and SCHOUERI (2016), pp. 213-221 for further elaboration on the differences between a "principle" and a "standard", although STORCK et al. (2016), p. 216 point out that the distinction between the two concepts may be "more a matter of semantics than enforcement". SCHOUERI also regards the arm's length principle as being a "criterion" and not a pure "principle", understood as an optimization mandate according to ALEXY's theory of principles. According to SCHOUERI, the arm's length principle would thus be a proxy to ascertain whether the ability-to-pay principle, as an expression of the principle of equality (true, plain "principles"), is met. Further elaboration on the discussion can be found in sec. 1.2.2.

10. *See* "transfer pricing" in *International Tax Glossary, Glossary IBFD*. Transfer pricing is "the area of tax law and economics that is concerned with ensuring that prices charged between associated enterprises for the transfer of goods, services and intangible property accord with the arm's length principle". Similarly, *see* TPG par. 11; PAGAN and WILKIE (1993), sec. 1.1.; BAISTROCCHI (2012), p. 10; LEVEY and WRAPPE (2013), par. 101; and COTTANI (2014), p. 29.

With regard to materials used in the elaboration of this analysis, two categories may be acknowledged. Primary sources of different jurisdictions, namely legislation, case law and administrative regulations, have been employed, along with secondary sources such as specialized literature, tax alerts and updates posted by legal and accounting firms on the Internet and official documents of international institutions. In order to compile and analyse this material (listed in the bibliography), recourse to the library collections of institutions in which the author undertook research stays were fundamental. These include the libraries of the Westfälisches-Wilhelms Universität Münster (Münster, Germany), the International Bureau of Fiscal Documentation (Amsterdam, the Netherlands), the Wirschaftsuniversität Wien (Vienna, Austria) and the Max Planck Institute for Tax Law and Public Finance (Munich, Germany). The author would like to express his gratitude to the directors and personnel of these institutions for their support during these research stays, which enhanced the quality of this book.

As for citations, when quoting specialized literature in the footnotes, reference is made to the surname of the author and the year in which the work was published, alongside the relevant page number(s) on which each idea can be found (a formula inspired by the Harvard-APA model), as it is understood that a complete reference to the title of each contribution is unnecessary and may needlessly expand the scale of each footnote. The reader can find complete references in the bibliography. This also explains why it was considered unnecessary to provide an unabridged reference the first time a source is quoted, this system being an optimal one when a bibliography does not exist, as, for example in articles published in journals.

Case law citations in footnotes use the name of the party that litigates against the tax administration, the name of the court (translated into English, if applicable), the jurisdiction and the year the decision was published. In this way, if the reader is unfamiliar with the judicial structure of the jurisdiction in question, he may obtain an approximate idea of the category of the courts issuing the quoted decisions. A full citation of each decision can be found in the bibliography.

## Notes

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