The Arm's Length Standard in the International Tax Regime: Methods, Problems and Proposals

Padrão Arm's Length *no Regime Tributário Internacional: Métodos, Problemas e Alternativas*

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Abstract
This essay depicts the arm's length consolidation as an international standard, the issues involving its implementation and solution propositions. For such, the study begins from the premise that there is an international tax regime as part of the international law and that transfer pricing, along with the arm's length standard, displays a manifested example of this thesis. It is noted, through the undertaken historical overview, the international adoption of such standard. Strengthening the idea, transfer pricing methods pertained to the arm's length principle are scrutinized, firstly the so-called traditional transaction methods, emphasizing comparability and secondly the transactional profit methods, in which the comparison between controlled transactions is still present, though flexibly. Furthermore, the existence of conceptual and practical problems surrounding the standard's implementation are identified, especially the lack of ideal comparables. Finally, the essay presents solution propositions. Some within the standard, through the adoption of new transfer pricing methods and others apart from the arm's length, indicating inclusively, its clash.
Keywords: transfer pricing, arm's length, international trade, multinational companies (MNC), transactional profit methods.

Resumo
O presente artigo descreve a consolidação do *arm's length* no regime tributário internacional: seus métodos, desafios e alternativas de implementação. Parte-se da premissa de que os preços de transferência, juntamente com o padrão *arm's length*, representam claro exemplo de que há um regime fiscal internacional como parte do direito internacional. Aliado à con-

cepção de um regime fiscal internacional é realizado primeiramente o exame dos chamados métodos tradicionais de transação, enfatizando a comparabilidade e, em segundo lugar, os métodos de lucro transacional, nos quais a comparação entre transações controladas ainda está presente, embora de forma flexível. O artigo propõe-se ainda a analisar a existência de problemas conceituais e práticos em torno da implementação do *arm's length*, especialmente a falta de comparativos ideais.
Palavras-chave: preços de transferência, *arm's length*, comércio internacional, empresas multinacionais, transferência de lucros.

1. Introduction

Globalization, an economic phenomenon experimented in the last decades, has brought, in an accelerated and irreversible way, an approach between people and markets. The technological advance in communication media has deeply facilitated the internationalization of relations within every field, obviously including the tax law internationalization.

As a result of this social and economic reality, authors sustain the need of an international tax regime. In this sense, Avi-Yonah supports the following thesis: "a coherent international tax regime exists, embodied in both the tax treaty network and in domestic laws, and that it forms a significant part of international law…" (AVI-YONAH, 2007:1). The author therefore indicates that the international tax regime is an important part of international law, as indicated by the international tax law evolution in the twentieth century.

Exemplifying his thesis, Avi-Yonah indicates the arm's length standard under transfer pricing (AVI-YONAH, 2007:2), that is, a consolidated standard adopted by a variety of nations: the ones integrating the OECD (Organization for Economic Co-operation and Development), as well as those not participating in it. Brazil, in spite of not its non-participation in the OECD, aimed at adopting the arm's length standard in its legislation on transfer pricing, as noted in Schoueri's lesson (SCHOUERI, 2006:19).

The search for an international tax regime is equally presented by professor Yariv Brauner when he supports the benefits of a true global approach. In a scientific article the aforementioned professor seeks to avoid an "all-or-nothing" perspective for the analysis of a possible World Tax Regime and prefers to explore each component of it as it is at present in light of a unification proposal. He states support to a gradual and partial harmonization (BRAUNER, 2002).

The consolidation of an international tax regime as part of international law and the resulting international tax harmonization establish undeniable benefits. Brauner lists some of them when he lectures that: "Harmonization reduces differences between the various tax systems, and, therefore, reduces arbitrage opportunities that may distort business decisions for tax reasons. In addition, a harmonized system reduces wasteful compliance, administrative and enforcement costs." (BRAUNER, 2002:5)

International tax harmonization has been subjected to cautious experiences, especially in the realm of consumption tax, as shown in the European Union with the adoption of the VAT system, Value Added Tax.

Depicting the European Community, Antônio Carlos Rodrigues Amaral lectures that such a community intended to establish an indirect tax capable of being, to some extent, neutral, *i.e.*, not generating misallocation of resources, to what the price of goods and services could be fixated according to the market forces integration, in a free competition system (AMARAL, 1995:38).

VAT is, therefore, considered the best tax for tax coordination ends, relatively to countries comprising regional economic groupings (AMARAL, 1995:38).

On the one hand harmonization reached great evolution in the consumption tax realm, most importantly in the European Community experience; on the other hand, harmonization struggles in the realm of income tax, prevailing domestic law once countries do not wish to lose the taxing power upon the income of individuals and corporations, even as a mean of political and economical policy.

Such phenomenon is be clearly noted in the European Union itself, when States abide to a common indirect taxation, through VAT, but preserve to themselves the legislation on income.

After these brief comments on harmonization, returning to the matter of globalization is required. "Globalization is a deterministic process" (BRAUNER, 2002:79). Its consequences, good or bad, occur and produce effects apart from the various manifestations of appeal and atonement widespread around the world (GREGORIO, 2011:74).

One of the consequences arousing out of the globalization phenomenon is the continuous growth process of major corporations, which has generated will for significant changes in the world economic context (AYRES BARRETO, 2001:97). By these means, there is an intense international circulation of capital. Some capital mobility takes place in transactions within the free-open market, where prices are, as a rule, known by everyone. Others, however, are practiced between related parties. In this case, we stand before the so-called transfer pricing.

Avi-Yonah states that transfer pricing lies at the heart of the international tax regime (AVI-YONAH, 2007:102). Transfer prices are remuneration for the transfer of goods, intangibles and the provision of services and loan capital among related enterprises. The importance of transfer pricing is considerable as almost 70% of cross-border trade in the world takes place between related enterprises (HAMAEKERS, 2001:30).

Let us notice, therefore, that the most significant parcel of multinational corporations hail this theme as the most important one as far as international taxation is concerned (COOPER, FOX, LOEPRICK & NOHINDRA, 2016:8). The reason why that is has to do with the significant change in international trade relations. As Schoueri explains, in order to expand its markets, companies were installed in various countries, keeping in each cell a distinct economic unity, competing with one another. Nevertheless, today transnational groups chose to concentrate their activities in large unities that enterprise worldwide (SCHOUERI, 2006:11)

Under this new globalization context, the transfer pricing displays, along with the arm's length principle, great importance to attribute profits made by related parties to enterprises operating in different countries (HAMAEKERS, 2001:30).

On this introductory session it is recalled that the arm's length standard, as traditionally conceived, responds to the transfer pricing problem by seeking to determine whether transactions between related taxpayers reflect their true tax liability by comparing them to similar transactions between unrelated taxpayers dealing at arm's length (AVI-YONAH, 2007: 3).

Thus, it can be noted the arm's length standard indicates that transfer prices should be as close as possible to the market prices, i.e., similar to the prices practiced by independent companies, unrelated parties. The arm's length price should be, nevertheless, the one that would have been agreed upon the non-related parties, involved in equal or similar transactions, under identical or similar conditions.

Therefore, the arm's length stands out as the guiding principle for the matter of transfer pricing, in order to ascertain more precisely the company's generated wealth. By these means, the substitution of the prices practiced in a transaction is accepted if, in its place, the values that more precisely capture the market prices are registered.

As will be noted in this research, both arm's length standard concept and objectives are clear. The arm's length standard problem relies on the comparison idea and the last in not always possible once the comparison between related enterprises transactions and independent companies do not always display the reality contained in the factual relations. In this respect, Yariv Brauner lectures that "the arm's length standard (being vague and easy to exploit) offers many valid determination methods, using, as mentioned above, approximations and comparables that are by definition, inaccurate" (BRAUNER, 2002).

In an attempt to promote an effective comparison where transfer pricing is applicable, the OECD handles the theme in the 3rd chapter of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, under the title comparability analysis, where five set out factors are considered determining for this analysis.

In spite of the entire supporting arguments done in behalf of the arm's length standard, there is a general mistrust in respect to its future, due to the presented problems surrounding its practice. Hubert Hamaekers even states that "after 70 years the arm's length principle seems to have reached the limits of its development" (HAMAEKERS, 2001:39). Yariv Brauner appoints that "the arm's length standard, in particular, has been harshly criticized, and the prediction is that it would, eventually, become extinct" (BRAUNER, 2002:19).

Presented these introductory considerations, we move on to the appreciation, briefly yet, upon the arm's length principle origins, its consolidation within the international tax regime, the problems involving its implementation and future proposals.

For such, the arm's length standard determination methods will be analyzed, beginning with traditional transaction methods, followed by transactional profit methods, contrasting such methods with the formulary apportionment, initially relegated to a subsidiary form of profit allocation on the one hand, but on the other hand it has recently found firm defenders (HELLERSTEIN, 2005).

This essay's objective is to report the arm's length standard evolution, its consolidation as an international standard, nevertheless subject to criticism, the problems of its implementation and proposals to solve them.

2. The arm's length standard consolidation

Based on the historical overview of transfer pricing in international tax regime, it is possible to assure that the arm's length standard was consolidated as an international standard, in spite of the problems and criticism towards its implementation, being adopted by the OECD, UN and US's Model Treaties.

Avi-Yonah stresses that "the standard applied in all tax treaties to the transfer pricing problem of determining the proper allocation of profits between related entities is the 'arm's length standard', which means that transactions between related parties may be adjusted by the tax authorities to the term that would have been negotiated had the parties been unrelated to each other" (AVI-YONAH, 2007:19).

In the same direction, indicating that the arm's length standard is a consolidated international reference, collaborating with the gradual and partial harmonization effort in the structuring of a possible World Tax Regime, Yariv Brauner expresses the following: "Transfer pricing seems, therefore, like one of the less problematic areas of international taxation to harmonize. Without to my agreement (or more likely disagreement) with the choice of the arms' length standard as the appropriate guiding standard, clearly, it is the center of current consensus, with little resistance at the governmental level." (BRAUNER, 2002:19)

Thus, despite Professor Brauner's expressed disaccord with the arm's length standard selection, the standard's consolidation as an international reference cannot be denied.

Luís Eduardo Schoueri, in a comparative law analysis, reports that the arm's length principle was generally adopted, through the law or administrative acts, by countries possessing transfer pricing norms. He presents, therefore, the experiences in Italy, Germany, Argentina, France and Japan (SCHOUERI, 2006:30-6).

The OECD, UN and US's Model-Conventions consolidate, albeit indirectly, the arm's length standard adoption. For example, the articulation of the arm's length price in the associated enterprises context is found in art. 9(1) of the OECD Model Treaty, which provides as follows:

> "Where (a) an enterprise of a Contractin State participates directly or indirectly in the management, control or capital or an enterprise of the other Contracting State, or (b) the same persons participate directly or indirectly in the management, control or capital or an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

The writing is the same as the one present in art. 9(1) of the U.S. Model income Tax Convention of November 15th, 2006 (AVI-YONAH & BRAUNER, 2005:506).

David Francescucci informs that the OECD Commentaries on art. 9 provide that the OECD Guidelines represent internationally agreed principles and provide guidelines for the application of the arm's length, with regard to which art. 9 of the OECD Model Treaty is the authoritative statement (FRANCESCUCCI, 2004:66).

It is important to observe as a general rule the paragraph 2 on the same art. 9, which requires:

> "Where a Contracting State includes in the profits of an enterprise of that State, and taxes accordingly, profits on which an enterprise of the other Contracting State has been charged to tax in that other State, and the other Contracting State agrees that the profits so included are profits that would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those that would have been made between independent enterprises, then that other State

> shall make an appropriate adjustment to amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other."

The aforementioned adjustment should be conducted in the realm of the mutual agreement procedures, required in the model-conventions arts. 25.

As observed on the historic notes presented on the last topic of this essay, the arm's length standard is originated and developed in the realm of the IRS and the American courts, on the trial of several cases involving the enforcement of this standard for the solution of the transfer pricing matter. Today, it expressly figures in the Section 482 regulation:

> "In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. A controlled transaction meets the arm's length standard if the result of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result). However, because identical transactions can rarely be located, whether a transaction produces an arm's length result generally will be determined by reference to the result of comparable transactions under comparable circumstances."[1]

Based on this regulation, some arm's length standard noteworthy characteristics are clear. The first of them is the transaction, which differs from operation. Several operations can contribute to the objective's conclusion of a single transaction. On the other hand, one single operation can realize the conclusion of several transactions (GREGORIO, 2011:72-3). Schoueri states that unfitted to the arm's length principle are those methods which overlook the transactions themselves, for pro data global results (SCHOUERI, 2006:28).

Another important element is comparability. As identified in American regulation, the controlled transaction will correspond to the standard if the results are consistent to the ones reached in identical transactions, practiced in identical conditions, by independent companies.

If such traits are present, the arm's length standard is applied as means of transfer pricing control. The standard, as analyzed, is widely diffused and consolidated in the international tax regime. It is an international standard, although inherently subjective and potentially difficult to apply.

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1 *1994 US treasury regulations under Section 482*. See: <http://www.gpo.gov>.

3. Transfer pricing methods

In the historical overview, the difficulties pertained to the arm's length method implementation in the US were exposed, accompanied by several applied Standards such as "fair", "full fair value" and "fair and reasonable". For the effective implementation of the principle, it was thus necessary to estipulate methods, from the 1968 Regulations on, followed by the OECD in 1979. Then, the transfer pricing determination methods emerged, divided in two large groups: the traditional transaction methods and the transactional profit methods.

3.1. Traditional transaction methods

The arm's length determination methods, denominated traditional, emerged in the 1968 American regulation, being equally adopted by OECD in 1979.

The first one of them is the comparable uncontrolled price, or CUP. This method contrasts a controlled transaction's transfer pricing with an uncontrolled transaction. CUP is the most reliable and preferable method. Avi-Yonah lectures that "there is an international consensus that CUP is the best method when it is possible. However, it is very uncommon for a true CUP to exist. Most parent companies do not sell both to subsidiaries and to unrelated buyers in the same market; it is costly to set up subsidiaries, and parent companies generally prefer to sell through local distributors when at all possible… Thus CUP almost never exists." (AVI-YONAH, 2007:105)

The method thus contrasts transaction prices if the circumstances in which they were done are comparable. Here the so-called comparability test comes to light. The non-controlled transaction prices approved by the comparability test will indicate the arm's length result. There is then a second step: the price comparison. The controlled transaction price may be, for taxing effects purposes, replaced in case it is not compatible with the arm's length. The size and quality of the transactions' sample approved by the comparability test are important factors for the method's reliability, for the purpose of making it the best method rule.

It is worth to remind that the 1994 American regulation decided to discipline the intangibles treatment separately, creating the comparable uncontrolled transaction (CUT).

Two other traditional transaction methods are the resale price and the cost-plus. They also relay on finding relatively precise comparables, but somewhat less precise than CUP. They are basically the same method, regardless their different premises (NAVARRO, 2017: 9).

The resale price method's starting point is the resale price of a good or a service acquired from a related enterprise for independent company. Based on this price a gross profit is calculated in order to reach the arm's length price which, in turn, becomes a parameter for the controlled transaction. The focus is on the resale margin comparison compatible with the costs and risks involved in operations between unrelated parties.

The cost-plus method is based on the costs pertained to the supplier of good or service divested to a related enterprise. On top of these costs an adequate gross profit is added to reach the arm's length price, that is, the parameter for the controlled transaction. The focus is on the comparison between the mark up value and the costs and risks involved among unrelated parties.

Avi-Yonah summarizes these two methods on the following terms: "Thus resale price and cost-plus use the same general way of calculating transfer pricing, with cost-plus starting from the manufacturer and resale price starting from the distributor. Transfer prices determined in the distributor's country use the cost-plus price. These pricing techniques are relatively simple but require a comparable firm to determine comparable profit margins." (AVI-YONAH, 2007:105)

According to the historical overview presented in the beginning of this essay the 1994 American regulation heralded the introduction of two new arm's length price collecting methods: the comparable profits method (CPM) and the profit split. Generically, both can be classified as transactional profit methods.

However, before analysing the aforementioned methods, it is interesting to note that under the terminology "fourth methods" the International Tax Law specialized literature handles a series of methods alternative to the transaction methods, including the profit based methods (SCHOUERI, 2006:106-8).

The prediction toward other methods was already present in the 1979 OECD Report: "MNE groups retain the freedom to apply methods not described in this Report to establish prices provided those prices satisfy the arm's length principle in accordance with these Guidelines."

Based on this report, Schoueri states that the international consensus hailed the use of any other method for collecting an arm's length price, giving preference, however, to the three standardized methods (SCHOUERI, 2006:202).

Therefore, even profit based methods should be reference themselves from a transaction. OECD conditions the profit based methods to a compatibility with the arm's length and, by extension, with OECD's Model-Convention art. 9, previously studied.

3.2. Transactional profit methods

The profit based methods arose with the 1994 American regulation, followed by OECD's adoption of similar methods present in the 1995 guidelines. According to Schoueri, the OECD's nowadays adopted stand allows profit based methods, if they come from transnational criteria, i.e., investigating the profit generated in every specific controlled transaction. The same report rejects methods based on global profit, seen as contrary to the arm's length principle (SCHOUERI, 2006:202).

The American regulation predicts the comparable profits methods (CPM) and the profit split. In the OECD, the CPM was replaced by the TNMM, transactional net margin method, preserving the profit split. Describing the occurred changes, Avi-Yonah summarizes it on the following terms: "Within a few weeks or the U.S. adoption of the regulations, the OECD put out new transfer pricing guidelines that embodied the same methods, forming a classic example of how the United States and the OECD often coordinate positions. The United States and the OECD regulations differ very slightly in some specifics but in general are almost identical." (AVI-YONAH, 2007:114)

Thus, it is clear that the transactional profit methods are accepted by both OECD and the U.S., based in transactions and comparisons, utilizing profit margins instead of prices.

The CPM and TNMM methods hold as a reference the profit level indicator, affixing the transaction's profit margin. The operate similarly to the resale price and cost plus methods once the arm's length price, used as parameter for controlled transactions, should be determined according to the arm's length net profit margin.

Following Avi-Yonah, CPM is probably IRS's favorite method. In the comparable profit method, you take a group of companies that are very broadly similar to the company of interest, meaning the company whose prices or profits you are trying to audit. From the taxpayer perspective this technique is somewhat difficult because the tax return data is only available to the IRS (AVI-YONAH, 2007:115).

Despite the disincentive for the taxpayers, this method has been the most utilized by the IRS, once it can obtain this information much more easily than through the traditional methods for comparability effects.

Analyzing the transfer pricing rules enforcement problems, theme yet to be investigated in this essay, Hubert Hamaekers prognoses the case number increment in which the CPM is chosen as the "best method." The professor thus explains: "The CPM is based on a comparison of the operating profit of the taxpayer with that of independent enterprises with similar types of transaction under comparable circumstances. Data on operating profits is easier to obtain than data on the prices of comparable products or data on gross profit margins, which is necessary for the increasing use of the CPM." (HAMAEKERS, 2007:115)

It can also be noted that both methods, CPM and TNMM demand a comparability test. The profit level indicators pertained to the uncontrolled transactions approved by the comparability tests integrate a sample that results in the arm's length outcome.

The second profit based method is the profit split, adopted by both US and OECD guidelines. There are situations where transactions made between companies are so intimately intertwined that they cannot be separately enlarged. Both controlled transaction parts put forth complex functions or posses intangible or exclusive assets. This configuration makes the comparable profit level margins or indicators impossible to be found.

In the profit split method the goal is to share the project's total operational profit originating the controlled transaction between the two companies related to a second allocation criterion that takes into account the relative contribution of each side to obtain the involved profit.

Whilst OECD's tolerance upon this method, identifying in it the arm's length standard, there are significant stands in the specialized literature regarding as method in close resemblance with the formulary apportionment. As is known, the formulary apportionment is rejected by the OECD who considers it contrary to the arm's length standard (SCHOUERI, 2006:208).

Avi-Yonah locates such matter stating that: "It is interesting to note that profit split does not rely on comparables at all, but rather relies fundamentally on the taxpayer's own results. In that sense is similar to formulary apportionment, although it is still accepted as an arm's-length method because it is in the OECD guidelines… However, this method and all other methods except formulary apportionment are within the international consensus because they are accepted as arm's length." (AVI-YONAH, 2007:117)

Thus, profit split is recognized in the US regulations as a specified method, subject to the best method rule. The OECD Guidelines 1995 treat profit split as a method subordinate to the three main methods, but in principle as an arm's length method (HAMAEKERS, 2001:37).

After the analyses of these arm's length price collecting methods the conclusion is that the institute obtained great evolution, consolidating itself as an international standard, regardless of the severe criticism and serious difficulties surrounding its implementation, which has led some specialists to underline the argument of its clash, indicating other solutions for the transfer pricing collection.

4. Problems with the application of arm's length standard

Based on this essay's study, two realities are easily noted. The first one is that nowadays the arm's length principle is an international standard to tax. Thus, the arm's length principle has emerged and developed as an international standard for the allocation between jurisdictions of the business profit of multinationals (FRANCESCUCCI, 2004:16).

This international standard is clearly perceived through the arm's length principle adoption and consolidation by the US, the OECD and the UN. Their model-Conventions all basically use the same concepts, values, principles and norms regarding the issue. Furthermore, the arm's length price collecting methods are fundamentally the same, with scarce differences; in the traditional transaction methods the three comparison models for price collection are identical, while in the transactional profit methods the profit split is the same, with little difference between the American CPM and the OECD TNMM.

It is important to remind that in the case of profit based methods, OECD only adopts them as a last resort, that is, there is preference towards traditional methods, while the modern American regulation proceeds in the opposite direction, given the best method rule adoption. On this point, Avi-Yonah reports that the old regulations specified the order in which the arm's length method had to be applied: the first option was to use CUP, then resale price, and then cost-plus. Only after attempting those three options were you allowed to use something else. In the new regulations that is no longer the case. Instead, this method uses the "best method rule" and requires us of whichever method best approximates the arm's length price and requires the fewest adjustments to the comparables (AVI-YONAH, 2007:14).

In any case, even with slight distinctions, it cannot be denied that the arm's length principle is an international standard followed by most countries, including those who do not participate in the OECD, such as Brazil.

If it is true that there is a consensus regarding the arm's length standard implementation, it is also admitted by both defenders and critics the problems posed for its application.

Hubert Hamaekers summarizes that "transfer pricing is a matter which raises many problems in its practical application. Several major complications arise, in particular, with the strong emphasis on comparables in the legislation and regulations of an increasing number of countries." (HAMAEKERS, 2001:35). There are great obstacles to apply the comparability test, once in most cases it is practically impossible to realize the comparison of goods and services between associated and independent companies. Therefore, as previously stated, the CUP method is little or never utilized, despite being the most adequate.

As stressed before, the arm's length stand possesses serious problems and propels severe criticism regarding its practice, despite its consolidation as an international standard. Avi-Yonah abides with the idea that the traditional arm's length standard has failed (AVI-YONAH, 2007:26).

Francescucci states that the arm's length price has indeed been subject to a number of criticisms, essentially pointing at its lack of conceptual soundness; the uncertainly and high administrative burden it creates for both taxpayers and tax authorities; the risk or economic double taxation; and the scarcity of market-based comparables (FRACESCUCCI, 2004:26).

Thus, conceptual and practical problems are noted in the arm's length standard implementation. Several authors highlight the conceptual flaw in the arm's length standard. Therefore, besides the practical aspects previously presented, given the difficulties in finding comparables and the economic Double taxation risk, there is a theoretical, ideological matter causing a serious problem in the arm's length implementation.

Walter Hellerstein argues that there is a fundamental theoretical defect in the arm's length/separate-geographic-accounting standard as applied to an economically integrated multi-jurisdictional enterprise… As *Alice in Wonderland*, it functions in a universe of unreality (HELLERSTEIN, 2005:108).

In the same direction, Avi-Yonah indicates that on the most fundamental level, the basic criticism of the arm's length standard is that it does not reflect economic reality. Multinationals does not regard each subsidiary as a separate entity which bargains with other subsidiaries at arm's length (AVI-YONAH, 2007:102).

Going back to Hellerstein's studies, the author presents his diagnosis about the conceptual problem on the following terms: "For the essence of the arm's length/separate-geographic-accounting technique of allocating the income of an integrated multi-jurisdictional corporation is to ignore the interdependence and integration of the business operations conducted in the various states, and to treat them, instead, as if they were separate, independent and nor integrated." (HELLERSTEIN, 2005:108)

Therefore, the existing conceptual flaw in the arm's length does not allow us to detect particularities pertained to the multinational groups. Behaviors generated by proximity, intimacy or freedom in the allocation of functions and risks between related parties are not, in most cases, observed by the arm's length standard. The standard not always accounts the scale economies and the interdependence of several activities created by integrated businesses. In sum, it does not depict the economic reality (AVI-YONAH, 2007:26-7).

Next to the conceptual flaw and the problem inserted in arm's length standard fundamentals, there is, as previously reported, practical problems.

In an article proposing the adoption of the formulary apportionment in the context of the arm's length standard, Reuven S. Avi-Yonah states that traditional methods did not work in the majority of transfer pricing cases. The author indicates that The General Accounting Office did a study in the early 1990 that indicated that in over 90% of the cases the three traditional methods could not be applied because comparables could not be found (AVI-YONAH, 2009:3).

Thus, it comes to surface that, in practice, the use of the traditional arm's length methods is difficult to be applied. Therefore, as seen on the historical overview, the American regulation, months later followed by OECD, brought new methods, based on profit, trying to hold the arm's length principle as an international standard to be followed. The profit split and the American CPM or the TNMM (OECD) use the transaction compatibility test, an important arm's length element, however the comparison degree is much narrower than the one intended for the traditional methods.

Avi-Yonah, in the article "The rise and fall of arm's length: a study in the evolution of U.S. international taxation" summarizes the practical problems originated from the arm's length standard implementation stating that the experience of the last twenty-five years indicates that the arm's length standard creates a climate of uncertainty and an immense administrative burden for the taxpayers, the IRS and the courts and provides ample opportunity for abuse (AVI-YONAH, 2007:27).

As a result of the problems, both theoretical and practical, involving the arm's length implementation and the acid criticism propelled by the institute, given the precedents of declarations regarding its clash, solutions for the matter of the transfer pricing collection have been sought, on the one had by the already consolidated arm's length standard in the international tax law and on the other hand by other mechanisms, especially the formulary apportionment.

5. Problem-solving propositions

On this essay's section, presenting ready and concluded solutions for the arm's length standard problems are not intended. That is not the objective of this simple monograph. It is intended, however, to briefly report the measures being taken and the theoretical propositions presented in order to offer a new perspective to the transfer pricing systematic.

Resuming the historical overview pervading the whole of this study, it is worth to remember that in 1928 the League of Nations organized a general meeting of tax representatives of the member countries. Two theories were presented: separate accounting theory and the formulary apportionment theory. As previously stressed, the first theory, in addition to the comparison with independent companies, integrating the separate entity theory idea, prevailed in the 1933 proposal, when the expression dealing at arm's length was born.

Since then, the arm's length standard was consolidated internationally, relegating the formulary apportionment to a subsidiary usage, in tune with the prevision found on the OECD Model-Convention's art. 7(4), in spite of the propositions to abandon, inclusively, the subsidiary implementation prevision[2]. The method is rejected by the OECD for incompatibility with the arm's

[2] OECD. *Report on the attribution of profits to permanent establishment*. Jul. 2008, at. 26. See: <http://www.oecd.org>.

length and its adoption would be retaken from the unitary accounting theory (SCHOUERI, 2006:208).

There are solutions to the problems involving the arm's length standard; solutions within the standard itself, using the new determination methods and solutions apart from the standard, as the formulary apportionment adoption.

On this respect, it is interesting to use Reuven S. Avi-Yonah's lesson defending the idea of substitution of the dichotomy between the arm's length and the formulary apportionment by the image of a continuum formed by two opposite poles. On the left pole would be the arm's length in its purity and on the other pole the formulary apportionment.

Differentiating both extremes, Avi-Yonah lectures: "The major difference between the ALS and the formulary method is that the ALS stars with treating each entity in an affiliated group as a separate taxpayer, hypothetically dealing with each other entity in the group at arm's length. Conversely, the formulary approach starts with the entire affiliated group as on unitary enterprise." (AVI-YONAH, 2007:4)

Once presented this polarity, it can be noted that CUP is the method in which the arm's length is found in its most pure form. It would be the one placed on the continuum's extreme left. The other two traditional methods represent one step away from the pure separate treatment of each entity in the group, because they involve taking the group's profits as whole, subtracting the profit margin allocable to the manufacturer or the reseller on the basis of comparables.

Next step is the "comparable profit method" (CPM), the major innovation of the regulations under Section 482 of the Internal Revenue Code, where the standard of comparison is very relaxed. The CPM falls into the traditional definition or the arm's length standard, but it still uses some form of comparables. Even further along on the continuum of possible methods of determining transfer prices is the "profit split" method. This method is very close to the pure formulary apportionment end of transfer pricing continuum. The difference is that some of the profits are allocated on the basis of comparables, and that the formula used to split the rest is more flexible than the traditional assets, payroll and sales-based formula used by states (AVI-YONAH, 2007:4).

About Avi-Yonah's lesson, even though someone does not agree with his defense of the formulary apportionment adoption (AVI-YONAH & CLAUSING, 2007), it holds the merit of presenting a historical interpretation of the arm's length standard, identifing the comparable attenuations that have been occurring within the standard's collection methods, especially with the profit based methods adoption.

Presenting solutions for the transfer pricing problem, particularly in the arm's length standard, Hubert Hameakers follows a direction similar to the one indicated by Avi-Yonah, stating that: "Solutions to the transfer pricing problem can be sought (1) within the ambit of the arm's length principle, (2) in reducing the impact of transfer pricing through the introduction of regional rather than national corporate tax systems or (3) in alternative methods of profit allocation." (HAMAEKERS, 2001:37)

It is on the last item presented by author cited above where the controversial formulary apportionment method can be found, contested and defended with the same emphasis by the international tax law scholars.

The formulary apportionment method consists in allocating a multinational group's global profits among its many segments according to a criteria previously established by a formula. The method needs three essential methods: global profits, predetermined formula and segments to be taxed by the method. This method is not confused with the profit split, once this shares between two related enterprises the negotiation's total profit originated from a controlled transaction, while the formulary apportionment shares the group's global profit, determined on a period of time, without limiting itself to the transactional matter. Thus, the method is also known as unitary method or global method.

Avi-Yonah lectures that this method involves treating affiliated corporations as a single, integrated unit and apportioning the income of this unit among tax jurisdictions based on a formula measuring objective factors such as assets, payroll and sales in each jurisdiction compared to the worldwide total (AVI-YONAH, 2007:28). In the same direction, Hamaekers indicates that formulatory apportionment methods allocate the consolidated profits of a group amongst the entities of the group in various countries by applying a particular formula, for instance, a formula based on a combination of turnover, costs, assets and payroll (HAMAEKERS, 2001:28).

Note that there is a resemblance between the formulary apportionment and the profit based methods, as already previously highlighted throughout this essay. David L. P. Francescucci perceives such resemblance. Nevertheless, the author clearly indicates the distinction, stressing that the profit split method is a type of transactional, bilateral method as opposed to a multilateral or global method. He adds: "Given their transactional scope, the profit split methods allocate the transactional profit (i.e. the profit pertaining to controlled transaction under examination) between the related parties to the transaction; they do not allocate the aggregate profit of the MNE between all of its constituents." (FRANCESCUCCI, 2004:32)

For the formulary apportionment defenders, the method is the safest one and also the one that best suffices the arm's length standard deficiencies once it makes a previously established judgment of equity. Hellerstein sustains it, once "the case for formulary apportionment rests on the belief that cross-border economic activity is becoming increasingly integrated and that efforts to identify the source of the income that such activity produces on a source of the income that such activity produces on a transactional basis is theoretically questionable and practically unadministrable" (HELLERSTEIN, 2001:111).

Nevertheless, let us not forget that the OECD report of 1979 does not support the use of formulary apportionment. As material objections against it, the report contends that: there is no clear relationship with the real economic situation of the relevant group companies; it may lead to random results; there will be administrative burdens for the tax authorities and the MNE; and the risk of double taxation exists in the case of divergent application by tax authorities (HELLERSTEIN, 2001:38).

In spite of the arguments presented by the method's defenders against OECD's objections, the last one's position stays put, making the OECD 1995 Guidelines go more deeply into the objections against formulary apportionment.

In sum, note that despite the arm's length conceptual and practical problems it continues to be adopted and consolidated as an international standard to be followed, despite the comparability criteria's flexibility occurred in the profit based methods and the formulary apportionment resurgence as a solution for the transfer pricing determination.

6. Conclusion

Technological evolution, especially in the areas of transport and communications, has caused a constant approach among countries, in an interconnection that seems to be irreversible. Economic globalization has brought markets and economies together. Globalization is a deterministic process (BRAUNER, 2002:79).

Within this process, the growth and consolidation of multinational companies is a striking factor. Xenophobic nationalism is an element completely out of trend, a speech alienated from reality, reason why it attracts fewer adepts each day.

The increment of economic and social international relations has conducted the need for an international tax regime. As seen before, such regime has been defended by renown and respected authors of the international tax law specialized literature.

The transfer pricing, along with the arm's length standard are presented, therefore, as an international standard for relations among groups, related enterprises transactions. This standard is followed by the U.S., by the OECD and by the UN, as the Model-Conventions on this regard are practically identical.

Thus, this essay aimed at analyzing the arm's length standard as a consolidated international standard originated from a historical evolution accompanied by the increment in economic relations and the development of international organisms, mainly in the last century.

The MNC' integration strengthening and the arm's length internationalization have geared serious problems for its implementation. Determination methods have been created and adopted uniformly as means of solving the subjectivity and uncertainty generated by the standard.

Initially, the traditional methods came to be, where comparability is stronger, mainly the CUP, where the comparables are most comparables. As the comparison hailed by the three traditional methods displayed difficult implementation, the American 1994 regulation, followed by the OECD in 1995, created the profit based methods.

Through the present study, it was depicted how the American CPM or the OECD TNMM, along with the profit split, began to be largely used, becoming currently and widely accepted. Some scholars, as explored here, understand that such methods, given the fragile comparability, resemble much more with the formulary apportionment than with the pure arm's length standard.

In an attempt to solve this conceptual flaw and the arm's length standard troublesome practice, propositions within and outside the standard itself are presented. There are propositions aimed at innovations within the arm's length standard, propositions for the formulary apportionment adoption, implying the arm's length abandonment and there are also propositions to adopt formulas in the context of arm's length standard, through a dialogue between the separate accounting theory and the formulary apportionment theory.

Let us note, therefore, that the arm's length is an international standard been adopted for decades on the transfer prices issue between related enterprises. However, it has been exposed to acid criticism and its future is uncertain. This is precisely why, in 2004, there was a panel discussion to honor Hubert Hamaekers's retirement from the chairman presidency of the International Bureau of Fiscal Documentation (IBFD), taking up the theme "Income allocation in the 21st century: the end of transfer pricing?". In fact, the discussion surrounded the most adequate method for transfer pricing determination: arm's length or formulary apportionment. The controversy still persists and the panel's pivotal question remains unanswered.

In face of such controversy, the only certainty of regarding the arm's length standard future is uncertainty, as ironically concludes Ricardo (GREGORIO, 2011:50).

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