European Business Initiative on Taxation (EBIT)

Comments on OECD Public Discussion Draft on BEPS Action 8-10: Revised guidance on Profit Splits

EBIT's Members at the time of writing this submission: AIRBUS, BP, CATERPILLAR, CONSTELLATION BRANDS, DEUTSCHE LUFTHANSA, DIAGEO, GSK, HUAWEI, INFORMA, INTERNATIONAL PAPER, JTI, PEPSICO, RELX, ROBECO, ROLLS-ROYCE, SAMSUNG, SCHRODERS, SHV, TUPPERWARE, UTC.

Submitted by email to: TransferPricing@oecd.org

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EBIT is grateful for this opportunity to comment on the OECD Public Discussion Draft on BEPS Action 8-10: revised guidance on Profit Splits (the "Discussion Draft") dated 5 July 2016. EBIT has a number of general concerns with the Discussion Draft which are set out briefly below.

- Some terms in the Discussion Draft are unclear or subject to different interpretation, for example value chain analysis or (sequential or parallel) integration. Further guidance on what is meant under those terms would be welcomed.

- The Discussion Draft seems to indicate that the profit split method (PSM) can be seen as the default method when risks are shared or in case of integration. The choice of the PSM for a particular case should be based upon a comparability analysis, including the delineation of the transaction and the functional analysis, the principle of the most appropriate transfer pricing method and leading to an arm's length result (including the use of one-sided methods). It should not allow a short-cut selection process in case of risk-sharing or integration. Such short-cut selection process may lead to more controversy between tax authorities (not agreeing on the application of the same method). At the same time disparities may arise between independent and associated enterprises as the arm's length standard may not have been properly applied.

- The 'risk' factor as discussed in the Discussion Draft should be given the appropriate weight in the discussion and find its right place in the functional analysis, which involves consideration of functions, assets and risks.

- The PSM should not be interpreted as a method for allocating worldwide profits, but should keep its status as a transfer pricing methodology.

We refer you to the four practical examples of profit split solutions from our day-to-day experience in the context of the OECD's work on BEPS Actions 8-10, which EBIT submitted to the OECD in December 2014 – see: http://www.ebit-businesstax.com/pdf/pwc-ebit-submission-to-oecd-profit-split-dec-2014.pdf. Some of the points implicit in those examples and the ones now included in the Discussion Draft are worthy of comment in the context of the questions raised in the Discussion Draft.

- It should not make a difference in the application of the PSM whether the transfer price is set on an ex ante basis (anticipated profits) or an ex post (actual results) basis. Transfer pricing methods and the selection thereof should be part of the correct application of the arm's length principle. This principle should apply regardless of whether anticipated or actual profits are used. One weakness of using a PSM on anticipated profits, however, lies in its dependence on the reliability and accuracy of the

financial projections used as indicated in the section on valuation methods under the revised Chapter VI.

- It is not clear what is meant by risk sharing in the context of the integration of business activities, in particular as several companies within a MNE may be liable to the same or similar risks. It cannot be concluded from that liability to the same risks that they are sharing that risk. Also between unrelated parties, enterprises may face the same risks. Sharing of risk is one of the factors that may lead to the conclusion that a PSM may be the most appropriate method, but it should not be determinative in and of itself.

- PSM is regularly used in royalty rate setting where the residual (or part thereof) is used as the basis for the determination of the royalty.

- EBIT agrees that the absence of reliable comparables or data should not in itself be a factor that leads to the selection of the PSM as most appropriate method. Furthermore, tax authorities should respect a reasonable weighting of the relevant factors used in the PSM.

- The Discussion Draft points out that sequential integration should not be basis for use of the PSM. At the same time, it should be made clear that parallel integration is not, of itself, a reason to apply the PSM. If it is the intention to refer to a specific distinction, then this should be clarified, but it may mean more than just 'similar and at the same time' as indicated in the Discussion Draft. Even in circumstances where there is parallel integration, the facts of a particular case may indicate there is no reason to use the PSM.

- In the case of sequential integration, parties may make unique and valuable contributions but do not necessarily share the economically significant risks associated with the transaction. Parties may co-operate extensively and may be exposed to the same business risks, but may not have agreed on sharing the profits from the proceeds of the end product. This is also linked to the use of the term 'unique and valuable contribution' which should be interpreted in a narrow way. The broader the concept of unique and valuable is defined, the less likely it becomes that the guidance is appropriate. The concern is that if the concept is not interpreted or defined in a narrow way tax authorities may interpret the concept differently (i.e. broader) which may lead to the inappropriate use of PSM. Further this different interpretation will lead to more controversy.

- It is doubtful whether a discussion of "synergies" is useful in determining whether a profit split is the most appropriate transfer pricing method. The terms 'synergy' is not defined objectively in the new Section D.8 of Chapter I. It cannot be the intention of the Discussion Draft to indicate that the presence of a synergy would determine that the PSM is by default the most appropriate method. Further, guidance is lacking on how to value or measure "synergies," which is an absolute necessity if the advantage or disadvantages of the synergies need to be allocated between the members of the multinational group proportionate to their contribution to the synergy. EBIT agrees with the guidance in the Discussion Draft that there is no need to use the PSM simply on account of group synergies alone. It would be useful to strengthen the guidance that existence of synergies alone should not lead to the selection of the PSM as most appropriate method.

- A value chain analysis (VCA) could be a useful tool in determining and analysing transfer pricing, but it should not be compulsory as a part of any transfer pricing analysis. There is a concern that VCA may be used to view the MNE as one entity, contrary to the arm's length standard. Another concern is that the existence of VCA could be interpreted that

the PSM is the default method, without the proper analysis. The Discussion Draft does not define the term 'value chain analysis'. It should be clear that a VCA is different from a functional analysis. VCA should not be construed as a transfer pricing method, but it is a tool that may give more insight in the business. It cannot replace the proper transfer pricing analysis, including the correct delineation of the transaction and functional analysis. We agree with the caution expressed in the Discussion Draft as VCA is not a precise process, varying in format and detail. It focuses on the relative contribution of different business processes, but may not always give an answer as to whether unique and valuable contributions exist, synergies are achieved or the PSM is the most appropriate method.

- Further guidance on identifying and measuring relevant splitting factors is appropriate. It would be helpful to have an indicative list of splitting factors, and at the same time recognise that not all splitting factors may be appropriate under all circumstances. A thorough functional analysis is key in identifying the split factors.

EBIT trusts that the above comments are helpful and will be taken into account by the OECD in finalising its work in this important area. EBIT is committed to a constructive dialogue with the OECD and is always happy to discuss.

Yours sincerely,

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For further information on EBIT, please contact its Secretariat via Bob van der Made, Telephone: + 31 6 130 96 296; Email: bob.van.der.made@nl.pwc.com).

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