

European Business Initiative on Taxation (EBIT)

Comments on the OECD's Discussion Draft on

**BEPS ACTIONS 8, 9 AND 10: DISCUSSION DRAFT ON REVISIONS
TO CHAPTER I OF THE TRANSFER PRICING GUIDELINES
(INCLUDING RISK, RECHARACTERISATION, AND SPECIAL
MEASURES)**

1 December 2014 - 6 February 2015

At the time of writing this submission, EBIT Members included: AIRBUS, BP, CATERPILLAR, DEUTSCHE LUFTHANSA, DIAGEO, GSK, INFORMA, JTI, LDC, MTU, NUTRECO, REED ELSEVIER, ROBECO, ROLLS-ROYCE, SAMSUNG ELECTRONICS, SCA, SCHROEDERS and TUPPERWARE.

EBIT Comments on BEPS Actions 8, 9, and 10: Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterisation, and Special Measures)

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Submitted by email to: TransferPricing@oecd.org

Brussels, 6 February 2015

Dear Andrew,

EBIT is grateful for this opportunity to provide comments on the OECD Public Discussion Draft on BEPS Actions 8, 9, and 10: Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterisation, and Special Measures), hereinafter: “the Discussion Draft”).

General comments

EBIT’s Members support the Discussion Draft’s efforts to provide additional guidance on the re-draft of Chapter I of the OECD Transfer Pricing Guidelines with a view to preventing BEPS.

We welcome the Discussion Draft’s revised Section D of Chapter I of the Transfer Pricing Guidelines in Part I which quite accurately identifies the limited situations where it makes sense to look past the contractual terms and documentation in order to determine the appropriate treatment for transfer pricing purposes.

EBIT also supports the Discussion Draft’s recognition that the delineation of transfer pricing transactions should reflect business realities, and should take into account actual conduct of parties and actual allocation of risk, and that contractual terms mirror these business realities best in principle.

We welcome the recognition by the OECD in the Discussion Draft that the identification and allocation of risks is an essential and inherent component of day-to-day commercial activities. EBIT Members consider that risk can be (and is) often centralised and managed most effectively away from where the operational activities are.

EBIT Members consider with regard to Part II that any special measures should ideally be consistent with the arm's length principle. The number of cases beyond the arm’s length principle where special measures are required, should in our view be kept to a minimum, and be applied as a last resort and back up to the guidance in Section D of the Discussion Draft. Such special measures should be invoked following a good faith negotiation between taxpayers and the tax administrations regarding the application of Section D. EBIT believes that it is essential to provide clear and unambiguous guidance and assistance to tax administrations which will allow them to apply the Transfer Pricing Guidelines correctly.

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Specific comments

D. GUIDANCE FOR APPLYING THE ARM'S LENGTH PRINCIPLE

D.1 Identifying the commercial or financial relations

EBIT Members would welcome further clarification of the broad scope of the Discussion Draft's concept of commercial or financial relationships between associated enterprises in the context of the Transfer Pricing Guidelines.

The Discussion Draft states in paragraph 3 that written contracts provide the starting point for delineating the transaction between independent enterprises and how the responsibilities, risks, and benefits arising from their interaction are to be divided. EBIT wishes to reiterate that written commercial contracts are more often than not at the heart of any commercial and financial arm's length relations between independent enterprises.

The Discussion Draft states that where no written terms exist or the conduct of the parties shows that the contractual terms are ambiguous, incorrect or incomplete, the delineation of the transaction "should be deduced, clarified, or supplemented by the tax administration based on the review of the commercial or financial relations as reflected by the actual conduct of the parties". EBIT is concerned that the subjective term "deduced" may be interpreted by tax administrations as giving them wider discretion in deciding for companies what is commercially reasonable and in disregarding contracts and transactions more easily. EBIT wishes to emphasise the importance of providing clear and unambiguous guidance to tax administrations as regards the correct application of the Transfer Pricing Guidelines.

The Discussion Draft in paragraph 7 refers to an example whereby a transfer of value through technical assistance may have been granted and introduces the concept of synergies that may have been created through "deliberate concerted action" or know-how which may have been provided through seconded employees or otherwise. EBIT urges the Discussion Draft to clarify what is meant exactly with the newly introduced concept of "deliberate concerted action" as it is not elaborated further, if and how this ties in or complements the widely accepted concept in transfer pricing of group synergies as an advantage of being part of a group, how it can be used in practice by tax administrations, and how consistency with the arm's length principle can be assured. Further guidance on this is important because the role of synergies in value creation is extremely complex and certainly not undisputed in the transfer pricing arena.

More generally, we are concerned that the concept of "synergies" and some of the other concepts used in this section of the Discussion Draft, such as "interdependencies", "coordination," and "integration", seem to be used inappropriately because they seem to assume that an MNC is a single enterprise. We also note that this theoretical framework in this section would make it easier to justify non-recognition of transactions and disregarding contractual allocations of risk, but it may not be fully in line with today's business realities.

D.1.1 Functional analysis

The concept of "capability" is added to the functional analysis as a factor in identifying the economic circumstances of the commercial and financial relations. EBIT Members are concerned that this addition introduces unnecessary complexity to the functional analysis and significantly increases the administrative burden for multinational groups. It may also lead to possibly different pricing for the same transaction based upon the "capabilities" of the parties.

EBIT Comments on BEPS Actions 8, 9, and 10: Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterisation, and Special Measures)

D.1.4 Business strategies

Further guidance regarding the analysis of business strategies and their impact on a controlled transaction would be helpful because otherwise the proposed analysis seems to merely introduce adding subjectivity to the risk analysis.

D.2. Identifying risks in commercial or financial relations

We welcome the statement that risk is inherent in commercial activities and that the identification and allocation of risks is an essential component of a comparability analysis.

EBIT's Members consider that risk can be (and is) often centralised and managed most effectively away from where the operational activities are.

We generally concur with the statement in paragraph 66 of the Discussion Draft that: "financial capacity to bear risk is a relevant but not determinative factor in considering whether a controlled party should be allocated a risk return."

As an example: an offshore cash-box provides finance to an operating affiliate, but (notwithstanding the contractual terms) the cashbox entity plays no material role in the management or control of risk, or in monitoring/reviewing the activities of those to whom it has outsourced the management or control of risk, and neither does it appear to have the capability to do so. In this case, we would agree with the proposition that the starting point in calculating the return to the cashbox company is that it should be a financing-type return – albeit a relatively high financing return reflecting the inherently risky nature of the activities being financed and the resultant uncertainty in the repayment of the financing.

Additional points – Imputed moral hazard

EBIT believes that whilst moral hazard exists in some but certainly not all third party transactions, it is very difficult under the arm's length principle to appreciate when moral hazard should be imputed in a multinational group.

D.2.5. Risk management

The Discussion Draft concludes too easily in our view that a company's decision to outsource risk mitigation or management, which is common commercial practice, does not involve risk and that such decisions will automatically result in that company losing control of the risk process or delegating all of the risk.

The Discussion Draft cites line management in business segments, operational entities and functional departments as a good solution. In practice, line management does not indicate per se whether the top level reporting entity really controls the risk or not, and we think it would be helpful if the Discussion Draft could clarify how line management and outsourcing risk management interlink and interact.

D.4. Non-recognition

Whilst EBIT Members welcome the statement that every effort should be made to determine the actual nature of the transaction and apply arm's length pricing to the accurately delineated transaction, and that non-recognition is not used simply because determining an arm's length price is difficult, the proposed Guidelines should ensure that taxpayers are not inappropriately confronted with non-recognition. In our view, non-recognition should therefore be explicitly mentioned in paragraph 82 as a last resort.

EBIT Members believe that the Discussion Draft's recommendation that an entity, which has a separate legal personality, can be disregarded, should be considered with great caution and

EBIT Comments on BEPS Actions 8, 9, and 10: Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterisation, and Special Measures)

applied only in cases where it can be clearly demonstrated that the involvement of a particular legal entity is a sham. To do otherwise, would undermine the fundamental legal concept of separate legal personality and unjustifiably breach the TFEU/EEA freedoms regarding EU/EEA national companies/other local entities. We would also point out that CJEU case law in our view severely limits the ability of EU/EEA tax authorities to lawfully recharacterise transactions, as to do so other than in the case of sham or wholly artificial arrangements fails to meet the legal certainty test laid down by the CJEU in the SIAT Belgian cross-border deductions case (C-318/10) as reiterated by the CJEU in the Itelcar Portuguese Thin cap case (C-282/12).

Part II – POTENTIAL SPECIAL MEASURES

EBIT Members consider that any special measures should as far as possible be consistent with the arm's length principle, and that there exists no consensus among the BEPS-44.

We are concerned that the Discussion Draft at this already late stage of the BEPS process does not provide specific or substantial guidance as to how these special measures would function and should be applied and implemented. In particular, where special measures are recommended beyond the reach of the arm's length principle, it seems to us that Article 9 of most treaties would have to be renegotiated in order for tax administrations to be able to implement these special measures.

We are very concerned that the implementation of special measures which are outside the arm's length principle will lead to an overall surge in instances of double taxation and cross-border controversies. It should be noted that these special measures would be outside the scope of the resolution mechanism of the Mutual Agreement Procedure.

It would be very helpful if the OECD could provide assurances and clear guidance to business that any special measures which are adopted outside the arm's length principle, will only be a last resort solution and a back up to the guidance in Section D of the Discussion Draft. They should in our view also only be invoked following a good faith negotiation between taxpayers and the tax administrations regarding the application of Section D.

EBIT believes that it is essential to provide clear and unambiguous guidance and assistance to tax administrations as well to allow them to apply the Transfer Pricing Guidelines correctly.

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

Yours sincerely,

European Business Initiative on Taxation – February 2015

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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