COMMENTS RECEIVED ON PUBLIC DISCUSSION DRAFT

BEPS ACTION 10: TRANSFER PRICING ASPECTS OF CROSS-BORDER COMMODITY TRANSACTIONS

10 February 2015
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Buenos Aires, February 2, 2015

Mr. Andrew Hickman
Head of Transfer Pricing Unit
OECD’s Centre for Tax Policy and Administration

E-mail Response: TransferPricing@oecd.org

RE: BEPS ACTION 10. Discussion draft on the transfer pricing aspects of cross-border commodity transactions

Dear Mr. Hickman,

The Transfer Pricing working group of the Asociación Argentina de Estudios Fiscales (Argentine Association of Tax Studies – AAEF) is pleased to provide comments on the OECD’s paper on Transfer pricing aspects of cross-border commodity transactions related to Action 10 of the BEPS Action plan.

AAEF is a non-profit organization based in Argentina, whose active members are recognized tax experts form both, private and public sector. AAEF is the local branch of the International Fiscal Association1.

We welcome the proposal to include additional guidance clarifying the application of transfer pricing rules on cross-border commodity transactions, in light of the specific features of such transactions and the concerns of commodity exporting countries to prevent the erosion of their tax base and profit-shifting.

We comment and assess the proposed amendments to Chapter II, hoping they can contribute to the better development of the subject.

General Comments

Introduction

It has to be highlighted that any amendment to the Transfer Pricing Guidelines in order to introduce the issue of commodity transactions should consider a holistic approach in order to

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1 Created in 1953, the Argentine Association of Tax Studies committed itself in its 61 years to promote research on Fiscal Law and related disciplines among its members.
allow a comprehensive understanding of the business and a proper performance of a transfer pricing analysis. This suggestion is in line with paragraph 7 of the draft, with which we fully agree.

As we are explaining later, among the features that distinguish commodity transactions, as an existing quoted price (which is transparent and volatile) and the delivery of the goods at a future date, it is important to take into account the specific price-setting methodology usually applied by the parties in the transaction as well as the participation of traders in the value chain. The last two aspects were not included in the discussion draft.

In our opinion, the new set of rules to be included to the Guidelines should preserve the application of the arm’s length principle while striving for the delicate balance between its purest version and the actual possibility to identify direct comparables in commodity transactions.

Taking this into account, our stance is the following:

- We consider it is positive that the Guidelines acknowledge quoted prices as benchmark values in applying the CUP method to commodity transactions, as well as the need to recognize comparability adjustments, where admissible.

- On the contrary, we do not agree with the proposal to introduce the shipment date as a “deemed pricing date” for application of the CUP method, even where it would be used exceptionally, because we believe that this outcome is not in line with the arm’s length principle.

- Clarifications about the particularities of the pricing process in commodity transactions and the role of the traders in the value chain should be included in the Guidelines.

**Experience in the application of the “sixth method”**

As Argentina was the first country to adopt the so-called “six method” as a solution to mitigate tax base erosion, and considering that the “deemed pricing date” proposed by the draft is equivalent, it may be instructive to consider what was the experience in this regard.

Under the “sixth method” the commodity transaction has to be priced, for transfer pricing purposes, at the quoted price in the transparent market on the shipment date, provided such quoted price is higher than the price agreed upon by the parties to the transaction. The method does not take into account the conditions agreed upon between the parties and the business circumstances, does not admit internal comparables and does not require that a range of comparable prices be developed.

According to Argentine rules, where the exporter makes a sale to a related company it is required to apply the “sixth method” if the other party to the transaction is a trader that does not meet the
conditions established by law; otherwise, if the trader meets the conditions or if it is the actual recipient of the goods, the CUP method shall apply.

The major practical difference between applying the “sixth method” or the CUP method in commodity transactions, lies in the date that should be considered to identify the benchmark quoted price, because in the latter case the price shall be the price agreed between the parties, but not the quoted price on the shipping date. However, the tax administration intended to apply the CUP method using the quoted benchmark price on the shipping date, on the grounds that in transactions between unrelated parties the agreed upon price tended to approach the quoted price on the indicated date. Such an approach was dismissed due to lack of empirical evidence by the judicial courts.

Other Latin American countries, such as Uruguay, Brazil and Paraguay, have also adopted specific transfer pricing rules for controlled commodity transactions but more flexible than the Argentine ones. They state the application of quoted prices in controlled commodity transactions, but on the date the prices are set between the parties, provided the taxpayer has reliable evidence of the pricing date actually agreed by the associated enterprises. The tax treatment is the same regardless of whether the related purchasing company is a trader or an actual recipient of the goods, provided the transaction is genuine.

Proposed additions to Chapter II of the Transfer Pricing Guidelines

Below we provide our feedback to each of the proposals included in the draft.

A. The use of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method

Paragraph 8

In our opinion, the Guidelines statement that the CUP method can be appropriate for the transfer between associated enterprises of commodities for which a public quoted price is available is positive, as the first paragraph proposed to be inserted in the Guidelines states.

Yet, we suggest an amendment to the wording of paragraph 8 eliminating the statement that the “CUP method would generally be the most appropriate transfer pricing method for commodity transactions”, since this statement is not consistent with the “most appropriate method” rule — adopted by the 2010 Guidelines — which is expected to result from the comparability process that

2 As for the grains and oilseeds markets, both tax authorities and taxpayers, consider daily index or average prices published by a government agency for purpose of customs duties as comparable prices in transfer pricing analysis.

3 Oleaginosa Moreno Hermanos SACIF judgment, hold by the Court of Appeals.
is performed in order to find the most reliable comparables, which 9-step typical process is described in Chapter III of the Guidelines.

The paragraph also includes a definition of commodities where the only feature is the fact that price setting between unrelated parties is based on a quoted price. Our suggestion is to include, in addition to transparent market prices, distinguishing features of physical goods, to wit, they are generally intermediary products, they are fungible to some extent, and they do not have associated intangible property.

Paragraph 9 and Second proposed paragraph to be inserted in the Guidelines

Paragraph 9 provides that quoted prices will generally provide evidence of whether or not the price agreed in the controlled transaction meets the arm’s length principle (citing by way of example the London Metal Exchange and the Chicago Board of Trade). This idea is further developed in the second paragraph that is proposed to be added to the Guidelines by indicating that such prices generally reflect the agreement between independent parties.

However, the draft document fails to acknowledge one essential aspect in relation to the use of quoted prices:

- The markets mentioned are derivative markets that do not replace the traditional markets where physical goods are traded, but rather complement those markets in mitigating (in the case of hedgers) or assuming (in the case of speculators) risks.
- These markets are located in certain financial centers—mainly in developed countries—that are far from production and business areas of commodity producers located in developed countries—which are mostly concerned about the erosion of the tax base.

To clarify the comments above, let’s say:
The producer/seller of commodities is located in Argentina, while the consumer / buyer is in Vietnam or New Zealand. a) who connects them? is there someone who makes the commercial effort to connect them or the mere existence of a quoted price ensures the transaction? b) what price are they going to use? the quoted price in Chicago? the quoted price in Chicago less the freight from Argentina to Chicago? the quoted price in Chicago plus the freight from Chicago to Vietnam or New Zealand?

This example leads to the following facts:
- The supply chain and the marketing know-how are important (this will be mentioned later where the traders issue is discussed)
- The price of physical transactions in general will differ from quoted prices in derivative markets; however they are generally based on such quotes. Such premium or discount (price difference of physical products in a given region vis-a-vis the derivative markets) will depend, not only on differences in terms of quality and the contractual terms pointed out by the draft, but also in the supply-demand dynamics in the relevant
geographic market at any given time, freight costs and other factors that are not necessarily related to the physical features of the products, like opportunity costs and bargaining power.

Therefore, even though the London Metal Exchange or the Chicago Board of Trade generate quoted prices, the price of deliverable transactions will generally include a premium or discount agreed upon between the parties, which are therefore added or subtracted, respectively, from the quoted price. Analyzing the value of this premium or discount becomes vital.

While the quoted price may be known in international markets and also reported by specialized firms, premiums or discounts in general do not have a transparent price in public markets. The value of these concepts should be validated by means of comparable data that may be gathered from internal taxpayer information, based on transactions with unrelated third parties, or on data published by agencies or brokers or else, by applying any other transfer pricing method, insofar as any such premium or discount may also reflect differences in functions and risks along the supply chain. As a consequence, insofar as the agreed upon price is determined through the quoted price plus a premium or minus a discount, the transfer pricing test will involve comparing the market value of the premium or discount against the value agreed upon between the associated parties.

We believe it is utmost important that the Guidelines should take into account this feature of the commodities market to better understand it and to facilitate an adequate comparability analysis that aims at selecting and applying the most appropriate method to each transaction.

Paragraph 10 and Third proposed paragraph to be inserted in the Guidelines

The statement about the need to make adjustments where there are differences that have a material effect between the terms and conditions of the controlled transaction and the uncontrolled transaction represented by the quoted price, (Paragraph 10) as well as the assertion included in the new paragraph to be added to the Guidelines whereby the commodity being transferred in the controlled transaction and the commodity in the uncontrolled transactions or in the comparable uncontrolled arrangements represented by the quoted price need to be similar, in terms of the physical features and quality of the commodity, do not address the aspect pointed out in the previous paragraph.

The consideration of premiums and discounts and the verification that the value agreed upon for such differentials meets the arm’s length principle is beyond the scope of comparability adjustments on the quoted price.

B. Deemed pricing date for commodity transactions

Paragraph 13
In our understanding, some assertions regarding economic aspects of the commodity transactions should be reviewed.

That is the case of the consideration about the sales of commodities for immediate delivery, because they do not necessarily attract a Premium over the quoted price as the document states. Depending on the economic and financial circumstances of the parties to the transaction, the price negotiated can be higher or lower than the quoted one. In order to avoid misunderstandings we suggest deleting the clarification between brackets.

In addition and according to our comments regarding paragraph 9, it could be convenient to clarify that not only the quoted price of the commodity may fluctuate in the period of time between entering into the contract and taking delivery of the goods, but also the premium or discount.

Another aspect that should be reviewed is the assertion regarding “the existence of evidence that commodity transactions generally tend to be priced by reference to a quoted price close to the time of shipment”. It has to be said that it is not the experience in Argentine markets. The price in transactions between independent parties generally is fixed at some point of time between the contract date and the shipping date or even after the latter one, e.g. in the case of transactions performed once the goods are on board or where a subsequent transformation of the exported goods needs to take place (e.g. certain mineral ores or concentrates). Another circumstance that could have an influence on the shipping date is the existence of governmental regulations that temporarily restrict the exportation of certain commodities, with the purpose of controlling domestic market prices, affecting the committed delivery date.

The assertion we are referring to is immediately put in perspective by the document stating that “options for fixing the Price at different periods can be built into the contract depending on the circumstances and risk appetite of the parties”. Thus, the assertion regarding the closeness between the pricing date and the quoted price at the time of shipment does not bring clarity about the pricing process. On the contrary it could lead to the wrong understanding that the regular behavior of independent parties is to fix the price in a period of time close to the shipment date and that other situations are exceptional, which is not real.

In our understanding it should be more useful to make an explanation about the different ways of building the prices in commodity transactions, distinguishing between:

- Flat prices: the price is fixed at the time of entering into the contract,
- Unpriced transactions: on the contract date, the parties fix the premium or discount to be added or deducted from the quoted price, which will be fixed in the future.
- Long term agreements: on the contract date the parties agree the transfer of the product and the committed volumes to be delivered at a future date. Determination of the date or dates for the quoted price used as benchmark and in many cases also the amount of the premium or discount are thus deferred.
As a consequence of the above possibilities, it is necessary to refer to price “dates” instead of price “date” as the document states.

We believe it is important to include these clarifications to provide insights to the tax authorities as to what is to be expected in setting prices for commodity transactions.

**Paragraph 14**

As we have already said, we consider the inclusion of the shipment date as the “deemed price date” in the Guidelines is inappropriate, even if this notion is to be applied solely in the absence of reliable evidence of the pricing date actually agreed by the associated enterprises. It is easy to realize that the CUP method considering the deemed price date is equivalent to the “sixth method”, in which connection the OECD document on Transfer Pricing and Comparability Data for Developing Countries established its concerns.

From a philosophical perspective such an assumption implies a departure from the arm’s length principle, since it cannot be claimed that in transactions between unrelated parties, the commodity price setting date is always identified with the shipping date. It is not true to fact and does not reflect use and practices in the industry; it does not even contemplate the minimum terms involved in logistics and customs clearance procedures.

Applying a deemed pricing date may be a legitimate rule for cases where the conditions of the taxpayers’ associated transactions are not at arm’s length, but such an outcome implies in essence the restructuring of the transaction, not in its nature, but in its conditions. In this regard, it would be advisable to simply refer to re-characterization or non-recognition rules set out in Section D.4 of the revision to Chapter I of the Guidelines (Public Discussion Draft on BEPS Actions 8, 9 and 10).

In introducing a “deemed pricing date”, the Guidelines should establish guidance to align this deemed date with common market practice, which do not necessarily coincide with shipment date and prevent abuse of this rule by the tax administrations. Namely, a provision should be included stating that the quoted price on the deemed date should be applied to all the transactions where the taxpayer fails to provide evidence to support the actual pricing date or dates, considering not only those transactions which prices are lower than the quoted prices on the deemed dates giving rise to an adjustment in favor of the tax authorities, but also those with higher prices compared to the quoted ones (giving rise to an adjustment in favor of the taxpayer). Obviously, should the application of a quoted price that is not common practice between unrelated companies be authorized, all transactions with no faithful evidence to support their pricing dates should be subject to the same rules, for any other solution would amount to deliberately authorizing over-taxation.

**Paragraph 15. Guidance to be inserted in Section B in Chapter II of the Guidelines**
We agree with the paragraph added to section B, Chapter II of the Guidance, up to and including the wording “If the pricing date actually agreed by the associated enterprises is inconsistent with other facts of the case, the tax administrations may impute an actual pricing date consistent with the evidence provided by those other factors of the case (taking into consideration industry practices)”. Our suggestion is to eliminate the text that follows, that is the authorization of tax authorities to allow the deemed pricing date for the commodity transaction to be the date of shipment, and the clarification that this would mean that the price would be determined by reference to the quoted price on the shipment date.

Moreover, the Guidelines should define more precisely, by way of example, the notion of reliable evidence that the tax authority may find acceptable to support the pricing dates, as well as which would be, by way of example, the “other facts of the case” that may reveal inconsistency of the actual pricing date agreed by the associated enterprises. To such effect, some countries – such as Uruguay and Paraguay – created a special registry for taxpayer to register their contracts for transfer pricing purposes, as well as any communication between the parties in relation to the price setting dates, in the case of “unpriced” or long term contracts.

The proposed solution highlights the core issue: the importance to provide reliable evidence of the price setting date/s in commodity transactions entered into with associated companies, given the relevance that such date/s has/have in identifying the comparable quoted price and relevant comparability data to test the premiums and/or discounts when applying the CUP method.

C. Potential additional guidance on comparability adjustments to the quoted Price

Two aspects should be explained given their incidence on agreed upon prices and the potential adjustments to quoted prices. We refer to premiums or discounts, and the participation of traders in the supply chain:

- The value of premiums and/or discounts applied to commodities quoted prices imply differentials that take into account the characteristics or circumstances surrounding the supply and demand in a given geographic market and the parties to the transaction. Such circumstances relate to the availability of the product, the financial situation of the seller, difference in the distance to competitive markets and associated freight costs, to name a few. In some specific cases, it may also involve differences in the associated functions and risks assumed by the parties in the supply chain. See our explanation in commenting on Paragraph 9 and Second proposed paragraph to be inserted in the Guidelines.

- As indicated above, the supply chain in commodity transactions is as important as in any other market. Traders routinely take part in the distribution of commodities; they buy the product and operate as the link between the concentrated supply in exporting countries and the demand from several countries. The trader assumes functions and risks related to the acquisition of goods—except storage—logistics, trading, collection and financing, etc. and face the risk of fluctuating prices. The exporter may, of course, develop
commercial functions and directly assume the distribution of products, transferring the goods to the importers, if that is how it wants to deal with its business. This applies both to domestic companies and multinational groups. Obviously, the mere fact that the transaction is entered into between the exporter and a trader should not be taken by the tax authority of the exporting country to challenge the price agreed upon for the transaction (nor the pricing dates), even when the trader is dealing exclusively for a related exporter or multinational group.

On the other hand, in the absence of quoted prices for different levels of transactions in the supply chain, the potential incidence of functions and risks related to the participation of a trader should be adjusted based on information that may support its arm’s length price, which information should be provided by the taxpayer, similarly to the verification of the arm’s length value of premiums or discounts.

Should you have any inquiries or doubts, please do not hesitate to contact us at the e-mail addresses below.

Sincerely,

Horacio R. Della Rocca: President

Cecilia.goldemberg@gshr.com.ar

José María Segura. Transfer Pricing Working Group Co-coordinator.  
segurajosemaria@yahoo.com.ar
We respectfully submit comments on the Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions (dated 16 December 2014) ("the Draft"). If there is any specific point from our comments that you would like to discuss further, please do not hesitate to contact us.

As a general comment, we are not experts on the commodities trading sector, so our comments to the Draft are from a general transfer pricing point of view.

The changes suggested to the OECD Guidelines on the Draft are not material and are mainly clarifications to the existing guidelines, therefore in principle we agree with them. On the other hand, we wonder why these additions are necessary. Each sector of the economy has specific transfer pricing questions that apply to them, and we don’t think it is the intention of the OECD Guidelines to address each of them.

The Life Sciences sector, the Technology sector, the Financial Services sector, the Professional Services sector. Each chapter of the OECD Guidelines, whether it is the chapter on methods, or intangibles or services, applies slightly different to each sector. Even within the same sector, there are differences between family owned companies and public companies, or between players at the top of the market (premium) or mid-market. We understand the reasoning explained in the Draft that for certain developing countries commodity production (harvesting, extraction or processing, etc.) is key to their economies but so is for example the tourism sector. We don’t have any guidance in the OECD Guidelines that refer specifically to transfer pricing challenges in the hotel sector which is the major source of economic activity for many developing countries: would a hotel chain need to charge lower royalties if the hotel was located in a fantastic and trendy and safe country-island than if it was located in a fantastic but not-so-trendy-and-not-so-safe-island -trends and safety change over time and may have not been considered in the purchase price of the hotel, that is why we refer to those factors.

If any, the commodities sector has the advantage, unlike many other sectors, that there is often plenty of third party public information that allows the taxpayer to use the CUP method. If we need to start defining specific ways to apply the CUP method, why not do that to the way the Resale Price Method or the TNMM can be applied?

The draft mentions in Section 2:

"2. [...] Countries have reported the following key transfer pricing issues that may lead to base erosion and profit shifting ("BEPS") in cross-border commodity transactions:

- The use of pricing date conventions which appear to enable the adoption by the taxpayer of the most advantageous quoted price;
• Significant adjustments to the quoted price or the charging of significant fees to the taxpayer in the commodity producing country by other group companies in the supply chain (e.g. processing, transportation, distribution, marketing); and,
• The involvement in the supply chain of entities with apparently limited functionality, which may be located in tax opaque jurisdictions with nil or low taxation.

Later on it mentions Section 12.4:

"In order to assist tax authorities in conducting an informed examination of the taxpayer’s transfer pricing practices, associated enterprises should document in writing, and include as part of their transfer pricing documentation, the price-setting policy for commodity transactions as well as any other relevant information related to the pricing of the commodity (e.g. pricing formulas used)."

In our experience, when a country’s economy is dominated or heavily reliant on one or two sectors, the government agencies, not only tax authorities but also regulatory authorities, education, infrastructure, etc. is also specialized in those sectors. In our example of the tourism sector, if all big hotel chains operate in a particular country-island, the government authorities know, or should know, more about that sector and how it works than even the headquarters of any specific hotel chain or their advisors. Same applies to commodities. It is not the responsibility of the multinational to train the tax authorities of a particular jurisdiction about the idiosyncrasies of the sector in which they operate: this is one of the reasons why they pay taxes in that jurisdiction. How the local government decides to spend that tax money is a different question.

As for the bullet point mentioning that: "The involvement in the supply chain of entities with apparently limited functionality, which may be located in tax opaque jurisdictions with nil or low taxation." This is a genuine concern. However, it would seem more appropriate to address this problem with other means than the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. For example, with the projects on exchange of information or with general anti-abuse rules targeting specific situations.

Specifically, with respect to the use of "the date of shipment as evidenced by the ship of landing or equivalent document depending on the means of transport" when there is no reliable evidence of the actual pricing date agreed by the associated enterprises this seems acceptable to us as long as this criteria is applied consistently.

We hope our comments above are useful.

With kind regards

Ágata Uceda

Agata.uceda@alumni.insead.edu
AOTCA Opinion Statement on the OECD 2014 Public Discussion
Draft on (BEPS Action 10)
The Transfer Pricing Aspects of Cross Border Commodity Transactions
Prepared by the AOTCA Technical Committee and submitted to the OECD on 4 February 2015

AOTCA was founded in 1992 by 10 tax professionals’ bodies located in the Asian and Oceanic regions. It has expanded to embrace 20 leading organizations from 16 countries/regions.

The foundation of AOTCA was attributed to the existence of the Confédération Fiscale Européenne (CFE), the international organization for tax advisors in the European Communities with a long history of 49 years.

Over the years tax professionals doing businesses in the Asian and Oceanic regions had been strongly conscious of the necessity that the same international professional body as CFE would exist in the area.

Introduction

The following comments relate to the OECD’s Public Discussion Draft BEPS Action 10 on the Transfer Pricing Aspects of Cross Border Commodity Transactions.

The Discussion Draft addresses problems and policy challenges in respect of commodity transactions faced by tax administrations, in particular tax administrations of commodity dependent developing countries. These include: (i) use of pricing date conventions which appear to enable the adoption by the taxpayer of the most advantageous quoted price (i.e., manipulating the pricing date); (ii) significant adjustments to the quoted price by charging significant fees to the taxpayer in the commodity producing country by other group companies in the supply chain (e.g., processing fees, transportation fees, distribution and marketing fees, i.e., converting some portion of pricing to fees); and (iii) the involvement in the supply chain of entities with apparently limited functionality, which may be located in no or low tax jurisdiction.

The above has actually led to some countries, for example, in South America, using specific domestic approaches for pricing commodity transactions (beyond the traditional methods), which has led to the OECD coming up with a draft discussion paper to deal with the above issues and to provide for a consistent set of rules.

Proposed additions to Chapter II of the Transfer Pricing Guidelines:

(A) Use of comparable uncontrolled price (CUP) method for pricing commodity transactions and the use of quoted prices in applying the CUP method – The notion being that (i) CUP can be an appropriate transfer pricing method for commodity transactions between associated enterprises; and (ii) that quoted or publicly available prices can be used under the CUP, as a reference to determine the at arm’s length price for the controlled commodity transactions.
Drawing on an example recently encountered, concerning the export of processed commodity from Country X to its related party in Country Y, in which CUP was used, and information from a publicly available database on commodity pricing was referred to, we have the following comments:

- Often trading companies may be serving as a “hub” and conclude contracts in their own name and at their own risk, while also performing support functions to the wider group. In that case, it may be difficult to find the appropriate CUPs as the transactions need to be divided. E.g., in the above example, the Country X entity may also do some processing while the commodity pricing shown in the database may or may not involve processing, or indicate the degree of processing being performed. One would need to segregate the processing function from the actual commodity prices. When dividing and splitting services, it may be burdensome to provide unequivocal justification for a particular split.

- In many commodity trading operations, e.g., in Hong Kong, the issues are also in the permanent establishment (PE). A Hong Kong trading company is needed mainly because of the financing operation. Commodity transactions generally involve significant amounts, and a highly sophisticated banking support system is needed. A HK entity may, for example, buy from a related company in Country A, which in turn purchases from arm’s length mining companies in Country A. The HK entity will then use its related distribution company in Country B to source arm’s length manufacturers as customers in Country B. This type of structure has a genuine business rationale, but tax rate arbitrage could be an unintended effect. Is there an avoidance of PE in Country B? The BEPS Action Plan on Preventing the Artificial Avoidance of the Permanent Establishment Status (action Plan 7) may also be relevant to the current action plan.

- Commodity market is highly standardized and uniform, yet prices are extremely volatile and future trends difficult to predict. The quoted price may be a good reference, but may not be a good CUP. Extensive adjustments may often be needed to account for the differences between the transactions evaluated and the comparable transactions found.

(B) Deemed pricing date for commodity transactions

- Paragraph 14 Discussion Draft indicates that (i) the absence of “reliable evidence”, (ii) the guideline would deem the pricing date to be the quoted price, incorporating any comparability adjustments, on the shipment date, as evidenced by the bill of lading or equivalent documents. But whether there is “reliable evidence” is or is not available is at the discretion of the tax administration.

- Often, for a commodity trading company in Hong Kong serving as a “hub”, in whose name are the trades concluded, it is not uncommon for a standard framework contract to be in place between the supplier and the hub company, on the basis of which the inter-company pricing is determined. Often, via such framework contract, a standard price may be agreed upon to limit the administrative burden and complexity, on the understanding that positive and negative results would level out in the long run. The question is then whether tax administrations would deem there to be sufficient “reliable evidence”, or whether the taxpayer would be forced to go with the deemed pricing date for each
transaction, which could impose a big burden on the taxpayer. It is recommended that the Working Party considers offering some guidance as to what should constitute “reliable evidence”, or even suggest some safe harbour rules in this regard.

- In the draft guidance in paragraph 15, the Discussion Draft suggests that resolution of cases of double taxation arising from application of the deemed pricing date should be through the MAP. However, this may not always be sufficient or effective. Possibly, a dual audit could be an alternative.

(C) Potential additional guidance on comparability adjustments to the quoted price

- The terms of the contract are often an indication of the comparability adjustments to be made to the quoted price. The Working Party could give more guidance in this regard. For example, a trader can often make additional profits because of the CIF and FOB terms, as it may find ways to make money on the logistics (e.g., by finding a better alternative in terms of shipping). The trading company involved should be entitled to this additional profit, which would often not be reflected in the quoted prices.
Dear Mr. Hickman,

BDI\(^1\) refers to the OECD Discussion Draft “Transfer Pricing Aspects of Cross-Border Commodity Transactions” issued on 16 December 2014. We would like to thank you for the possibility to provide our comments that allow us to engage with you on these important issues. We have limited our comments on some general issues.

We support the OECD’s work to assure that transfer pricing outcomes are in line with value creation. We welcome the efforts to provide a consistent set of rules within the arm’s length principle to determine the arm’s length price for commodity transactions. These efforts should be aimed at substituting specific domestic approaches for pricing commodity transaction, as they have been adopted by a number of commodity dependent countries (eg the so-called sixth method).

Therefore, clarifications and guidelines in this regard are welcomed since they create a homogenous and consistent framework for all the market players. Similarly, we encourage the OECD to engage with non-OECD members to obtain further commitment on a common treatment.

However, it should be noted that commodities can have very different characteristics and their markets and respective value chains can also differ significantly, which does not always allow applying general rules or principles.

\(^1\) BDI (Federation of German Industries) is the umbrella organization of German industry and industry-related service providers. It speaks on behalf of 36 sector associations and represents over 100,000 large, medium-sized and small enterprises with more than eight million employees. A third of German gross domestic product (GDP) is generated by German industry and industry-related service.
The comparable uncontrolled price (CUP) method would generally be the most appropriate transfer pricing method for commodity transactions to the extent the conditions for the comparability analysis are duly met, and assuming that reasonably accurate adjustments are admitted to ensure that the economically relevant characteristics of the transactions are sufficiently similar. In addition, the use of quoted or publicly available prices, as a particular application of the CUP method, has been used for many years by industrial MNEs in order to determine the arm’s length nature of their related party transactions affecting commodities. We therefore welcome any initiative that facilitates agreement and standardization of the sources of information that should be used for the application of this approach. In this regard, we would like to note that the use of quoted prices is, in many cases, the most appropriate starting point for a transfer pricing analysis supplemented with discounts and/or premiums to allow for comparability adjustments where required.

Certain commodities, however, are not priced through (long-term) contracts, but priced on a transactional basis. In these cases, for documentation purposes, flexible approaches need to be accepted by the tax administrations to validate the arm’s length nature of these transactions, in order not install excessive administrative burden for businesses.

With regard to the deemed pricing date for commodity transactions, no unequivocal answer can be provided to identify the best date to which the quoted price should be referenced; market practices vary depending on the commodities traded, geographic market, interests of the parties, circumstances of the transaction, etc. We therefore propose that the terms adopted by related parties are the basis for the agreed pricing date. We assume that contractual arrangements between the parties involved would be sufficient to reliably evidence the agreed pricing date. Therefore flexibility should be allowed in connection with the deemed pricing date proving that such date is aligned with the respective industry practice.

Please do not hesitate to contact us if you have any questions.

Sincerely,

[Signature]
Florian Holle

[Signature]
Dr. Karoline Kampermann
BEPS MONITORING GROUP
Response to Action 10 Discussion Draft on the Transfer Pricing Aspects of Cross Border Commodity Transactions

This report is published by the BEPS Monitoring Group (BMG). The BMG is a group of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. This paper has not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives.

We are grateful for this opportunity to comment on the proposals for dealing with deductions of charges for intra-group services within multinational corporations (MNCs). This forms part of one of the three actions in the BEPS project relating to transfer pricing, which is a key aspect of international corporate taxation.

This paper has been prepared by Veronica Grondona and Sol Picciotto, with comments from other members of the Group. We would be happy to contribute to the public consultation on this issue.

1. General Remarks

A. The Need for simplified transfer pricing methods

1. The OECD began to coordinate transfer pricing rules with its report of 1979, but by the late 1980s significant difficulties had been identified with the application of the arm’s length standard, due principally to the difficulty of identifying suitable comparables. The introduction by the US into its transfer pricing law of the ‘commensurate with income’ concept in the Tax Reform Act of 1986 created disagreements between the US and other OECD members. These disagreements eventually led to the introduction of the transactional net margin method (TNMM) and the profit split method, described as transactional profit methods when they were formally included in the Transfer Pricing Guidelines of 1995. Despite the apparent consensus around the arm’s length principle, its application in practice has continued to be problematic. The experience in practice is that there is a lack of adequate comparables, especially in small and underdeveloped economies. This requires the use of sophisticated microeconomic techniques, which nevertheless can produce only a range of possible arm’s length prices that far too often is significantly broader than good tax policy could ever suggest. With such wide ranges, even small differences can have a significant effect on the attributable profit. Hence, re-evaluation of transfer pricing rules is long overdue.

2. Developing countries have generally introduced transfer pricing rules much more recently. Although some, such as Argentina, have long had provisions in domestic law allowing adjustment of accounts of local affiliates of foreign companies, they have only relatively recently adopted the OECD Guidelines. Others have done so even later, often as a result of ‘capacity building’ by the OECD and other organisations, which have regrettably sought to encourage them to adopt methods which the OECD countries have long known are defective. Unsurprisingly, they have experienced even greater difficulty due to the lack of local or even regional comparables. Some have introduced methods which are easier to administer, such as Brazil’s legislatively fixed margins, and the so-called Sixth Method for

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1 See our comments on the OECD report on Transfer Pricing Comparability Data and the Use of Comparables, April 2014.
commodities (using prices quoted by exchanges, at fixed dates) in Argentina\textsuperscript{2} and other Latin American countries. Some countries which have tried to apply the full range of OECD-approved methods have found that they nevertheless generate disagreements, conflicts, and a high number of legal disputes with taxpayers. India, with some 3000 cases pending before its tax tribunals, is the most notable example of this. For the large majority of developing countries the introduction of transfer pricing rules based on the OECD Guidelines is much more recent; many have only begun implementing them very recently, and some not yet.

3. Hence, in our view there should be a fundamental re-evaluation of the OECD approach to transfer pricing, and not just a patch-up of the current rules. The wide variety of available methods, and the need for detailed ‘facts and circumstances’ analysis to apply most of them, have created a system which is difficult to administer and leaves considerable scope for subjective judgment.\textsuperscript{3} As all countries around the world now begin to implement these rules with more rigorous audits, they are therefore likely to lead to greater uncertainty and conflicts. At the same time, they impose significant strains on especially the poorer countries, which can ill afford to waste scarce human resources operating a dysfunctional system.

B. Legislating for the world

4. This discussion draft proposes revisions to Chapter II of the OECD Transfer Pricing Guidelines. Other reports in the BEPS project are also proposing revisions to many of the other chapters, which in the end will be substantially rewritten, although only in a piece-meal way. Introducing changes by revising the Guidelines is no doubt a convenient way to introduce changes quickly even on a global basis. However, it is important to consider the implications of this procedure, and adopt appropriate arrangements to mitigate its dangers. In principle, the Guidelines constitute only international ‘soft law’, since they are not formally binding on states. In practice, however, they are often incorporated into domestic law, directly or indirectly. This means that once adopted they can immediately create legally enforceable rights and obligations. For example, in the UK, the Guidelines are given direct effect by statute, which also means that changes could become immediately effective.\textsuperscript{4} In other countries they may also be directly applied as ‘aids to interpretation’.\textsuperscript{5} This may be the case even in non-OECD developing countries. For example, in Kenya the High Court allowed a company to use a transfer pricing method relying on the Guidelines even though those Guidelines were at that time not mentioned anywhere in Kenyan law.\textsuperscript{6} Similarly, a

\textsuperscript{2} Argentina has had provisions in domestic law in relation to the pricing of intragroup commodity trading since 1947, due to the importance of such economic activity in its national product and balance of payments.

\textsuperscript{3} This is spelled out in more detail in our submission on Risk, Recharacterisation and Special Measures.

\textsuperscript{4} The Taxation (International and Other Provisions) Act 2010 s.164 provides that UK treaty provisions based on the OECD Model should be interpreted ‘in accordance with’ the Guidelines and with any documents published by the OECD as part of the Guidelines prior to May 1998, and any documents designated in an Order made by the Treasury after that date as comprised in the Guidelines.

\textsuperscript{5} For example the Tanzania Income Tax (Transfer Pricing) Regulations 2014 s.9 specifies that those regulations shall be ‘construed in accordance with’ both the OECD Guidelines and the UN Manual ‘as supplemented and updated from time to time’. Hence, although Tanzania is not represented in the working parties or other groups working on BEPS, any revisions of the Guidelines which result from their work will have some direct effect in Tanzanian law.

\textsuperscript{6} Allowing an appeal by Unilever against a transfer price adjustment by the Revenue Authority under the Kenyan statute, the court accepted Unilever’s arguments that its pricing was based on methods accepted in the Guidelines. ‘We live in what is now referred to as a “global village”. We cannot overlook or sideline what has come out of the collective wisdom of tax payers and tax collectors in other countries. And especially because of the absence of any such guidelines in Kenya, we must look elsewhere’. (Judge Alnashir Visram, Unilever Kenya v. KRA 2005, 12).
Malaysian court has upheld a transfer pricing method based on the Guidelines, rejecting an adjustment made by the tax authority under local law, which it held to be invalid.\(^7\) A tax tribunal in India has even recently referred to the discussion draft on Intangibles issued under the BEPS project, although it has not yet been approved and incorporated into the Guidelines.\(^8\)

5. Thus, in effect by rewriting the Guidelines the OECD Committee on Fiscal Affairs is creating new tax norms for the world. Yet, the procedures for adopting these global rules involve little if any democratic accountability, and indeed make it difficult for all but the hardened specialist even to understand what is being proposed. Failing this, it is important to adopt some minimum procedural safeguards. The issues addressed are inevitably technical and specialised, but this should be all the more reason to make special efforts to engage in a dialogue with the public. In the case of this particular Discussion Draft, there has been little attempt to provide an analysis of the case of commodities, and it fails to provide an adequate explanation of the reasons that have led developing countries to adopt the Sixth Method. The approach used in this Discussion Draft discourages broad participation and greatly adds to the opacity and lack of accountability surrounding transfer pricing. It creates major entry barriers tending to confine discussion of the issues to a closed group of persons with long familiarity with the texts. Yet the importance of the BEPS project, and the potentially immediate and very wide impact of revisions of the Guidelines, clearly requires a widespread and well-informed debate on the issues involved. While the OECD has made efforts to consult with the community of tax experts, little or nothing has been done to reach out beyond this closed group. In this sense, although Working Party 6 integrated several developing countries representatives, it could not include all of them, since the OECD is not the place where all developing countries can find a voice and a vote to represent them. In addition to that, the Working Party should have worked at the complete revision of the transfer pricing methods, and not marginally in the creation of an amendment to the comparable uncontrolled price method.

6. Hence, we call on the Committee on Fiscal Affairs to rethink the approach which has been adopted to the writing of reports, especially in relation to transfer pricing. They should begin by explaining clearly the issues involved, including a frank appraisal of the limitations of existing approaches. Changes and the reasons for them should be explained clearly, and alternatives should be presented and evaluated. Finally, both clean and red-lined versions of amended portions of the Guidelines or other applicable documents should be produced before the final package of BEPS proposals are adopted, and an opportunity should be provided to evaluate the changes as a whole.

2. \textsc{specific comments}

\textbf{A. Dealing with the lack of suitable comparables}

1. The DD first proposes a ‘clarification’ in Chapter II of the Guidelines that ‘the comparable uncontrolled price method (CUP) would generally be the most appropriate transfer pricing method for commodities’. The specific proposals are then put forward simply as a modification by addition of a few paragraphs to the existing chapter II, which is based on assumptions derived from the independent entity principle. This fundamentally misunderstands the nature of the problem, and the reasons which have led developing countries to adopt the so-called Sixth Method. The central problem underlying the


\(^{8}\) Watson Pharma Pvt Ltd vs. DCIT (9 January 2015) ITA No. 1565/Mum/2014, para. 61
commodity transactions between two related parties is the lack of validity of the price settled by such an agreement. Independent parties trading commodities settle their agreements in open markets and generally based on future prices. However, such conditions are necessarily different between related parties where such transactions take place within large corporate groups. These are generally vertically-integrated, so that the commodity is transferred to the related party for processing and perhaps eventual use in manufacturing; or they are large diversified commodity traders and brokerages. Transfers within such large integrated corporate groups cannot be regarded as in any way equivalent to transactions between unrelated parties. This gives rise to a range of problems for tax authorities seeking to establish an appropriate level of profit for the commodity producing subsidiary of such a group.

2. First is the question of risk. Due to the characteristics of the extractive industries producing such commodities, the producer faces risks resulting either from natural causes (i.e. the weather) or from the volatility of the markets which often produce wide price fluctuations, or indeed both. An independent producer can try to manage such risks by using forwards contracts, and may also benefit from knowledge of published prices where there is organised trading of derivative contracts based on relevant commodities. However, an integrated firm can internalise this risk management, by combining the relative security of supply due to involvement in production, with the management of stocks and ultimate delivery. Often, it assigns the trading activity to an affiliate to which it attributes substantial risks and capital, in order to justify the fact that it receives a disproportionate profit margin.

3. Secondly, the commodity supply chain often includes a number of other activities which are generally internalised within integrated corporate groups, such as logistics, insurance, transportation and commercialisation. Like commodity trading, these functions may also be assigned to separate affiliates which, because of the nature of the functions concerned, can easily be organised so that their profits are attributable to jurisdictions where they will be subject to low levels of taxation. Thus, commodity producing countries face the situation where the profits attributable within an integrated firm to physical production are often far lower than those to related service activities. Since such service activities are easily organised in such a way as to bear low taxes, this is a major source of BEPS. The BEPS effect in respect of transactions with commodities and extractive industry is possibly even more critical for developing countries than similar practices in other sectors of economy. This is due to the primary importance and key nature of this industry for the economies of many developing countries and thus inherent reliance and dependency of the state budgets of these countries on the tax revenues from these commodity producing or extracting activities.

4. In this context, the standard OECD approach to transfer pricing is clearly unsuitable. The Guidelines specify that the starting point in evaluating the profits of associated enterprises should be the transactions between them, which are supposed to be evaluated by reference to comparable transactions between unrelated entities. However, it should be clear that a transaction between related parts of an integrated corporate group has none of the characteristics of a contract freely negotiated between truly independent parties, since all of its terms and conditions will have been decided administratively and aimed at maximising the benefits to the firm as a whole. Indeed, in the case of primary commodity production, the producing affiliate will generally be very much subordinate to the concerns of the firm’s head office, which is likely to focus on the upstream and marketing aspects of the business. In our

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view, therefore, such contracts should not be considered the starting point\textsuperscript{10}. Recognising the lack of suitable comparables in many cases, the OECD has increasingly moved towards the attribution of profits based on the functions performed, assets owned and risks borne by the various affiliates. In our view, this also is unsuitable, since MNEs design corporate structures involving functional fragmentation frequently with BEPS objectives, as described above.

5. It is therefore, in our view, mistaken for the DD to assert that the comparable uncontrolled price is the appropriate method of adjusting the profits of associated enterprises which are producers of commodities, and misleading to say that quoted prices can be used as a CUP, subject to comparability adjustments. It should be made clear at the outset that the Sixth Method is not a version of the CUP. The adjustment of the profits of associated enterprises is not a matter of finding the ‘correct’ prices for transactions between them. The Sixth Method should be understood as using quoted prices for relevant commodities to establish a clear benchmark which results in attributing an appropriate level of profits to the affiliate producing the commodity concerned.

6. The Sixth Method has been adopted by a number of developing countries because it has a number of advantages, but they have also in practice experienced difficulties applying it. Its advantages are that a quoted price can provide a clear and relatively objective point of reference to challenge the prices attributed in transactions between related entities. In some circumstances it may be possible to identify such a price which can be used as an appropriate benchmark, usually with some modifications, if applying it seems to result in an appropriate level of profit. This can establish a basis for rules which are easy to administer and do not involve either subjective judgment or detailed examination of facts and circumstances.

7. The difficulties which have been experienced are both in identifying a suitable benchmark and because, once such a benchmark has been established, it is possible for the firm concerned to organise the transactions between its affiliates to take advantage of it. An important element in this, which is not mentioned in the DD, is that transfer pricing documentation is generally presented to the tax authorities after the transaction has been made, enabling the adoption by the taxpayer of the most advantageous quoted price. This seems to have been overlooked in the DD, for example when it refers in paragraph 4.2 to the possibility of using a deemed pricing date, but only ‘in the absence of evidence of the actual pricing date agreed by the parties to the transactions’. What should be mentioned is the impossibility of considering an agreement between two related parties as sufficient proof of the date of settlement of the price of the commodity transaction.

8. Paragraph 6 refers to the difficulty faced by tax authorities ‘in obtaining information to verify the price of commodities, including pricing date conventions and comparability adjustments.’ In reality, the problem is rather that such an agreement and all its contents, including the date, are a consequence of that intra-group relationship, and have not been the result of a negotiation between independent parties. In relation to the ‘conventions’ mentioned, the export of commodities, when performed between independent parties, is generally done through contracts for futures. However, when the two parties are related ones, a ‘future sale’ does not make sense, unless it has been performed between the firm’s trading arm with third parties and afterwards settled with the related party exporting the goods.

\textsuperscript{10} For a discussion on the validity of contracts within economic groups, see e.g. Corti, A.H.M. (2012) “Algunas reflexiones sobre los mecanismos de exacción de la renta impositiva nacional. A propósito de las ficciones de contratos al interior de los conjuntos económicos.” Derecho Público Nro 2. Editorial Ministerio de Justicia y Derechos Humanos de la Nación. ISSN: 2250-7566. Year 1, Number 2, October, 2012.
Hence, the relevant concern should be how to apportion the aggregate profits resulting from the combined activities, based on the real economic activities in each country.

9. Another point overlooked in the DD is the relevance of the risk involved in commodity production for export. This is indeed generally ignored in the evaluation of related party transactions, and risks are generally considered to be borne by the upstream entities engaged in trading and commercialization. In our view, as explained in more detail in our submission on Risk, Recharacterisation and Special Measures, it is inappropriate to accept any such attribution of risk to a particular part of an integrated firm. One of the main reasons for the existence of such firms with their ability to internalise and integrate activities is precisely to share risk. Generally the attribution of the bearing of risk to a particular affiliate in such a firm should be disregarded, as it is likely to be BEPS-motivated. In evaluating the appropriate level of profit for a production subsidiary, it is relevant to take into account the inherently risky nature of the production of primary products, which is generally reflected in wide fluctuations in market prices, and consequently of government tax revenue from such activities. Also, access to raw materials could be considered a type of location-specific advantage, which should justifiably an appropriate profit adjustment.

10. Paragraph 7 mentions that research will be undertaken as part of the Tax and Development Programme ‘to identify common adjustments to quoted prices to account for physical and functional differences in the controlled transaction and with that supplement the BEPS work with practical tools to help developing economies make maximum use of quoted prices for commodities.’ We suggest that this work should primarily be performed by researchers in the developing countries themselves, where very complete knowledge is generally present of the problems faced. One such is that of the mis-categorisation of goods, for example exporting gold together with common rock, in order to make a reference to quoted prices inappropriate.11 Such practices border on evasion, and it is these that should be reviewed before any possible adjustments are normalized in order to reduce the market price of the commodities for comparability purposes.

11. Paragraph 12.2 to be included after paragraph 2.16 of the Guidelines states that ‘A relevant factor in determining the appropriateness of using the quoted price for a specific commodity is the extent to which the quoted price is widely and routinely used in the ordinary course of business in the industry to negotiate prices for uncontrolled transactions comparable to the controlled transaction.’ However, it should be made clear that such quoted prices should refer to geographically relevant markets, in order to avoid, as much as possible, the excessive use of comparability adjustments.

12. Paragraph 12.3 to be included after paragraph 2.16 of the Guidelines points to only some of the many aspects to be taken into account in comparing a quoted price with the actual relationships between a commodity production and the rest of the MNE group. In our view, these many differences mean that the aim should not be to conduct an exhaustive and detailed comparability analysis of all the contracts involved to arrive at the ‘correct’ price. This would undermine the main advantage of the Sixth Method, which is to provide a clear and objective standard, which is easy to administer. We suggest that quoted prices should be used as a guide, taking into account the comparability factors mentioned here (and others), on the basis of which the tax authority should establish a benchmark price. Such a price should be one that results in an appropriate level of profit for the affiliate

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11 A description of these practices can be found in Gutman, N. (2013) “Argentina en la frontera minera”. Ediciones del CCC Centro Cultural de la Cooperación Floreal Gorini; CEMoP. 1era edición. Buenos Aires, 2013
based on its activities in the country, and taking into account the value it creates for the MNE as a whole. Using quoted prices as a starting point for attempting to identify a ‘correct’ price by considering the many possible adjustments to be performed, would be a pointless cat-and-mouse game. For example, some adjustments would relate to the premiums for quality, but are very difficult to apply in practice, since misclassification of goods in order to settle prices that are different from appropriate market quotes are unfortunately part of the commodity market’s practices. Certainly, selection of the appropriate quoted price to use as the basis for a benchmark should take account of issues such as quality; factors such as delivery date are better dealt with by taking an average over a period of time; and other adjustments could be made to take into account the advantages a production affiliate provides to an integrated group of security of supply.

13. Paragraph 12.4 to be included after paragraph 2.16 of the Guidelines sets a good intention that would serve the purpose of good practices within MNEs and for auditing purposes.

14. The proposal to introduce a ‘deemed pricing date’ for commodity transactions is once again based on the mistaken assumption that the Sixth Method is based on the CUP method. It proposes that such a deemed date would apply only ‘in the absence of reliable evidence of the pricing date actually agreed by the associated enterprises in the controlled commodity transaction.’ However, what is lacking is a clarification of what would be the ‘evidence’ of the pricing date agreed between two related parties. As we have argued above, the Sixth Method should aim to establish a suitable benchmark price. If it is considered desirable that this price should be in relation to a date, an objectively verifiable date could be chosen, e.g. the shipping date as suggested by the DD, because it needs to be settled and verified by an institution controlling both the physical shipment and the parties involved. Another possibility which should be mentioned is to use an average of prices over a longer period of time. This may more accurately reflect the relations within an integrated MNE, in which a producing affiliate’s role is to ensure continuity and stability of supply.

15. We suggest that a clearer appreciation and explanation of the Sixth Method as involving a benchmark and not a CUP, as well as being easier to administer, would make it easier to reduce possible conflicts both with taxpayers and between tax authorities. It would eliminate the need for detailed analysis of individual contracts, and retrospective price adjustments, and provide greater stability. It is obviously important that such a benchmark should be set at a level which results in a level of profitability which fairly reflects the activities carried out and value provided by the relevant producer affiliate within the corporate group concerned.

16. While we recognise that the current system as represented by the entire Guidelines will not disappear immediately, it must be recognised that it is inherently a defective system. Hence, the current reform proposals should be formulated in a way which begins to establish more secure foundations for the system. For those reasons, we applaud the attempt in this DD towards a consideration of the reality of developing countries and all other efforts that would improve administration and cost-effectiveness; although, as has already been mentioned at the beginning of this document, the OECD is not the place for a discussion that will affect all developing countries, the majority of which do not have a voice or vote at the OECD.
Dear Andrew,

BIAC thanks the OECD for the opportunity to provide comments on its three Discussion Drafts covering elements of Actions 8, 9 and 10 of the Base Erosion and Profit Shifting (BEPS) Action Plan issued on 16 & 18 December 2014 (the Discussion Drafts). We acknowledge and thank you for the huge amount of effort that you and others have put into these drafts.

There is no doubt that transfer pricing issues, along with deductible payments, lie at the heart of the BEPS project. Governments have expressed concerns about aggressive structures in certain contexts, lack of clear (or any) guidance in others, and the perceived inability of the fact-driven arm’s length standard to deal with new situations in still others. BIAC agrees that all of these areas should be examined, and that the legitimate concerns of governments fully and swiftly addressed. However, BIAC also believes that the arm’s length standard, properly applied by both taxpayers and governments, still offers the best prospect of classifying transactions according to “real-world” economics, and equitably and consensually dividing income between countries based on economic activity. If this is not clearly articulated, however, then we will see a further acceleration in a worrying trend already apparent in the transfer pricing audit practices of several countries, where a broad interpretation of “BEPS principles” is used to justify new unilateral theories, and the automatic application of non-arm’s length approaches in routine situations.

So, elements of the proposed guidance in currently unclear areas such as risk or commodity transactions are greatly to be welcomed – but such guidance should build upon established concepts rather than upon new ones (such as, for example, “moral hazard”). Likewise, profit splits may well be appropriate in certain difficult cases – but the default position, nevertheless, should be application of the arm’s length standard, with profit splits only being applied where the default position cannot be. Recharacterisation, or “special measures”, which recast a contract or other legal arrangements from the form agreed by the parties into a new and different form, may be justified in egregious cases – but only when other alternatives, most particularly, the proper application of intercompany pricing principles, have been tried and failed. While it may sometimes be more time-consuming to run through a full functional analysis, than to move swiftly to a recharacterisation, such a functional analysis (the elements
of which are broadly agreed and widely understood) not only provides more commercial certainty for taxpayers, but also benefits governments because there will be fewer instances of double taxation as different countries seek to apply different rules with no commonly-agreed standards.

Finally, and as noted in my comments on Action 14, particularly if dispute resolution is not improved, then business may return to a more adversarial relationship with tax authorities and, especially in the complex area of Transfer Pricing, seek new ways to mitigate double taxation in the face of risk from ad hoc recharacterisations, and non-arm’s length practices. A return to this type of cat and mouse game would be to neither the advantage of governments nor the vast majority of responsible, unaggressive taxpayers.

In each of our three sets of comments, we give much more detail on where we think the new proposals will eliminate BEPS-related issues, and/or provide new and helpful guidance. Likewise, in our comments we also present what we hope are constructive alternatives, where we disagree with proposals made in the three Discussion Drafts. To reiterate, however, while we acknowledge weaknesses and gaps in the current rules, and are supportive of moves to rectify both, we also strongly advocate that the arm’s length standard, and the legal form adopted by taxpayers, remain the starting point – if not always the ending point – for dealing with the matters raised in Actions 8-10.

We very much hope that you find our comments useful, and we look forward to working with you on these important issues over the next several months.

Sincerely,

Will Morris
Chair
BIAC Tax Committee
1. BIAC supports the OECD’s work on transfer pricing aspects of cross-border commodity transactions as a crucial issue that many MNEs face in their day-to-day business. Clarifications and guidelines in this regard are welcomed as a way to improve the understanding of commodity businesses and create a consistent framework and a methodical approach for analyzing commodity transactions. The approach should, however, not be overly simplistic to avoid solutions that are inconsistent with the arm’s length principle. As we understand the Discussion Draft does not represent a consensus view, we encourage Member States to reach agreement to reduce double taxation on the topics described. Similarly, we encourage the OECD to engage with non-OECD members to obtain further commitment to a common approach.

2. Commodity markets are very complex and involve the participation of different key players in the supply chain until the product is delivered to the final consumer (e.g. producers, brokers, traders, marketers, distributors, etc.), with the traders performing a critical role based on the necessary assumption of a wide range of risks and functions inherent to international commodity trading transactions. Therefore, tax administrations’ understanding of this critical role forms a core part of the transfer pricing discussion on commodities.

3. In relation to the OECD’s broader work on Action 10, BIAC does not believe that services provided by a trader in relation to the supply chain should be considered “low value-adding” in nature, as per the definition and examples set out in the discussion draft entitled “Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-group Services”.

4. We believe that, if supported by a broad international consensus, further OECD guidance in this area under the arm’s length principle, could and should replace local and fragmented approaches to analyzing cross-border transactions affecting commodities (e.g. the so-called ‘sixth method’, implemented with particularities in each jurisdiction where it has been adopted). Applying an internationally agreed pricing framework to such transactions should facilitate taxation according to value creation in addition to the avoidance of potential double taxation and mitigation of base erosion practices.

5. For industrialized markets, the pricing of commodity transactions is of a great importance, given their significance to the value chains of many MNEs and given the importance of the taxation of natural resources to certain countries. The proper valuation of transactions affecting commodities should result in appropriate taxation across the different jurisdictions. We note that such industries, countries and commodities can have very different characteristics, increasing the difficulty of applying specific rules or principles to all situations.

6. The CUP method would generally be the most appropriate transfer pricing method for commodity transactions to the extent the conditions for the comparability analysis are duly met, and assuming that reasonably accurate adjustments are admitted to ensure that the economically relevant characteristics of the transactions are sufficiently similar. It is therefore critical that tax administrations prove that those conditions are respected if they intend to impose the CUP method.
7. Under the CUP method, the arm’s length price (or arm’s length range since the same commodity may be quoted in the different commodity exchange markets with slightly different prices and/or the price of a commodity may change in a very short period of time in the same commodity exchange market) for the controlled commodity transaction can be determined, not only by reference to comparable uncontrolled transactions, but also by reference to a quoted price with its subsequent corresponding adjustments, if applicable. Accordingly, alternative methods should not be necessary given the specific characteristics of commodities (such as pricing methodologies) in transparent and standardized markets and where information is available and allow for a reasonable and fair analysis. Nevertheless, it is worth mentioning that the underlying principle should remain to apply “the most appropriate method” which will often be a CUP. However, in practice, in markets which are not highly liquid or where products are not standardized, it is often not feasible to reach an acceptable degree of comparability (e.g.: gas, LNG cargoes delivered in a closed area, power in poorly connected regions, etc.). In addition, for vertically integrated businesses, it is not uncommon to have a specific allocation of risks that makes the application of a CUP method difficult. In such cases transactional methods are often applied.

8. The use of quoted or publicly available prices, with appropriate adjustments, as a particular application of the CUP method, has been used for many years by industrial MNEs in order to determine the arm’s length price of their related party commodity transactions. BIAC welcomes any initiative that facilitates agreement and standardization of the sources of information that should be used for the application of this approach. In this regard, we noted that the use of quoted prices is, in many cases, the most appropriate starting point for a transfer pricing analysis supplemented with discounts, premiums and other appropriate adjustments (e.g. remuneration for traders, distributors, marketers, transportation, etc.) to allow for comparability adjustments where required. It should also be noted that there can be different quotations for the same commodity in different commodity exchange markets. The number and the difficulties to realize those adjustments should however not be underestimated.

9. For many standardized commodities, it is common that prices agreed between independent parties are made up of a market reference plus or minus a premium or discount due to different factors such as quality, volumes, availability, etc. In these situations, the alignment of the related party transaction with the arm’s length principle will rest not only on the market reference itself, but also on the additional elements. The market reference component usually represents by far the largest element of the actual price agreed.

10. Transactions involving commodities within a MNE can be established through (long-term) contracts where pricing formulas are applied for all transactions performed under the agreement. In such cases, for documentation purposes, once the pricing formula used is tested, all transactions conducted following that formula should be considered to be arm’s length. However, for certain commodities, market practice would suggest that prices are agreed on a transactional basis, taking into account the spot market or forward market. That would mean no general formulas or policies would or should be applied to such transactions on a related party basis – instead, the transaction price will be established on a case by case basis looking at the market at the moment in time when the deal is closed (using quoted prices, similar transactions, etc. and building up
the final price as a market reference (for a given pricing period) plus a premium or discount to account for comparability adjustments. Industrial companies dealing with commodities perform several thousands of spot or forward transactions every year. Documenting compliance with the arm’s length principle for each of these transactions is a substantial administrative burden. We believe that tax administrations and taxpayers should work to develop a more pragmatic approach to reduce the burden: for example, agreeing on the principle of using quoted prices supplemented with comparability adjustments, using sampling or selection methods to identify the most relevant transactions, etc.

11. In connection with the deemed pricing date for commodity transactions, no unequivocal answer can be provided to identify the best date to which the quoted price should be referenced; market practices vary depending on the commodities traded, geographic market, interests of the parties, circumstances of the transaction, etc. For example, for forward prices the relevant date is not the date of delivery (i.e. date where the commodity is put at the disposal of the buyer) but the trading date (i.e. date where the transaction is concluded).

12. BIAC requests the OECD to further clarify what constitutes “reliable evidence” and proposes that terms adopted by related parties should be the basis for the agreed pricing date. However, where no reliable evidence is available of the terms adopted or where the date is inconsistent with other facts of the case, tax administrations should have the burden of proof and should seek to gather the relevant facts of the commodity, the producer, its customers and the characteristics of the market in which the commodity is sold, in order to establish the pricing date that would be most appropriate from an arm’s length perspective given market practices. The deemed pricing date should only be used as a method of last resort (i.e. an anti-abuse measure) in cases where the tax payer has failed to provide any reliable evidence.

13. Therefore, BIAC proposes that the terms adopted by related parties should be the basis for the agreed pricing date. The contractual arrangements between the parties involved should generally be sufficient to reliably evidence the agreed pricing date. Therefore, flexibility should be allowed in connection with the deemed pricing date proving that such date is aligned with their industry practice.

14. With regards to the selection of the index or exchange price to be used, it should be noted that there could be a number of indices for the same commodity observed in third party transactions, and thus, flexibility should be allowed by tax administrations as long as sufficient comparability is granted. This may include the different grade/quality of a particular index and a customer’s preference for that grade/quality. For example, in the mining industry, Richards Bay Coal indices are for a lower grade coal that is attractive to a certain market, compared to Newcastle coal indices which has higher calorific values and lower ash and sulphur content which typically achieves a premium.

15. In conclusion, we support the direction of the OECD’s work and we are willing to accept the OECD’s invitation to provide further information on how commodity markets operate, the important role centralized marketing organizations play in the value chain and specifically how comparability adjustments are set. BIAC also believes that the
proposals described in the Discussion Draft (quoted price, date of shipment) should not be presented as presumptions that the taxpayer must rebut. This would shift the burden of proof to the taxpayers, and would reflect different principles to those used in the pricing of transactions between unrelated parties. A greater emphasis should be made on building tax authorities’ knowledge and capacity in commodity industry practices to ensure the arm’s length principle is consistently applied, rather than developing a rigid or restrictive set of conditions and guidance on applying quoted prices and pricing/sources of differentials as well as selection of pricing dates.
Submitted by email: TransferPricing@oecd.org


Through its members, BUSINESSEUROPE represents 20 million European small, medium and large companies. BUSINESSEUROPE’s members are 41 leading industrial and employers’ federations from 35 European countries, working together since 1958 to achieve growth and competitiveness in Europe.

BUSINESSEUROPE is pleased to provide comments prepared by the members of its Tax Policy Group, chaired by Krister Andersson, on the OECD Discussion Draft entitled “Transfer Pricing Aspects of Cross-Border Commodity Transactions” 1 December 2014 — 6 February 2015 (hereinafter referred to as the Draft).

General Comments

BUSINESSEUROPE supports the OECD’s work to assure that transfer pricing outcomes are in line with value creation.

BUSINESSEUROPE supports the OECD’s work on transfer pricing aspects of cross-border commodity transactions as a crucial issue that many MNE face in their day-to-day business. Clarifications and guidelines in this regard are welcomed since they create a homogenous and consistent framework for all the market players.

We encourage OECD Member States to reach agreement to reduce double taxation on the topics described and to engage with non-OECD members to obtain further commitment on a common treatment in order to avoid double taxation.

Since commodity markets are very complex and involve the participation of different players, we consider that tax administrations’ understanding of this critical role forms a core part of the transfer pricing discussion on commodities.

Further developments on this topic, mainly consisting of a set of rules within the arm’s length principle, should be aimed at substituting local approaches to analyze cross-
border transactions affecting commodities (i.e. the so-called sixth method, implemented with particularities in each jurisdiction where it has been adopted); BUSINESSEUROPE considers these measures will have a positive impact on adequate taxation according to value creation, as repeatedly stated by the OECD, avoiding potential double taxation and base erosion practices.

From a business perspective, especially for industrial markets, it is obvious that a common regulation of commodity transactions is of a great importance, given its significant weight in their value chain of many MNEs. A proper valuation of transactions affecting commodities will result in proper taxation across the different jurisdictions where the MNEs have presence.

In addition, many MNEs are conceived as integrated businesses, including in their value chain, for example, the whole production process; relevant implications arise from this scheme as related party transactions conducted by group companies will not always be perfectly comparable to those conducted by independent parties. Although no clear answer has already been provided by either Tax Administrations or international organizations and the priority of the arm’s length principle is one of the fundamentals of transfer pricing, flexible approaches should be further analyzed in this regard.

Nevertheless, it should be noted that commodities can have very different characteristics and their markets can be significantly different, being their value chain also clearly different what does not allow applying always general rules or principles.

The use of quoted or publicly available prices, with appropriate adjustments, as a particular application of the Comparable Uncontrolled Price method, has been used for many years by industrial MNEs in order to determine the arm’s length price of their related party commodity transactions.

BUSINESSEUROPE welcomes any initiative that facilitates agreement and standardization of the sources of information that should be used for the application of this approach. In this regard, we noted that the use of quoted prices is, in many cases, the most appropriate starting point for a transfer pricing analysis supplemented with discounts and/or premiums to allow for comparability adjustments where required.

For many commodities, it is common that prices agreed between independent parties are made up of a market reference plus or minus a premium or discount due to different factors such as quality, volumes, availability, etc. In these situations, the alignment of the related party transaction with the arm’s length principle will rest not only on the market reference itself, but also on the additional elements. The market reference component usually represents by far the largest element of the actual price agreed.

For documentation purposes, we consider that there is a relevant difference between commodities that are priced through long-term contracts and commodities in which the
market practice consists of agreeing prices on a transactional basis, considering the spot market. In the first case, price formulas are applied for all transactions performed under said agreements and once the pricing formula used is tested, all transactions conducted following that formula should be considered to be arm’s length. However, in the second case, no general formulas or policies are applied for a group of transactions but on a transaction by transactions basis. Therefore, the transaction price will be set independently for every transaction looking at the market in the moment of time when the operation is closed. In this last case, industrial companies dealing with commodities perform several thousands of spot transactions every year, which represent an excessive administrative burden in order to document each of them for transfer pricing purposes. Tax Administrations should be ready to accept alternative approaches to validate the arm’s length nature of all the transactions conducted under this scheme: for example, agreeing on the principle of using quoted prices supplemented with comparability adjustments, a sampling or selection of the most relevant transactions.

In connection with the deemed pricing date for commodity transactions, we propose that terms adopted by related parties is the basis for the agreed pricing date. We assume that contractual arrangements between the parties involved would be sufficient to reliably evidence the agreed pricing date. BUSINESSEUROPE requests OECD to further clarify the point what constitutes reliable evidence. However, only in case, no reliable evidence can be provided of terms adopted or the date is inconsistent with other facts of the case, tax authority should seek to gather the relevant facts of the commodity, the producer, its customers and the characteristics of the market in which the commodity is sold, in order to establish the pricing date that would be most appropriate from an arm’s length perspective given market practices. Such deemed pricing date should be used as a method of last resort (anti abuse measure) given the starting position for the pricing date should be based on the terms adopted by the taxpayer.

With regards to the selection of the index or exchange price to be used, there could be a number of indices for the same commodity observed in third party transactions. This may include the different grade/quality of a particular index and a customer’s preference for that grade/quality. For example for the mining industry, Richards Bay Coal indices are for a lower grade coal that is attractive to a certain market, compared to Newcastle coal indices which has higher calorific values and lower ash and sulphur content which typically achieves a premium. For the gas business, Liquefied Natural Gas (LNG) sold in Asia can be based on a number of different pricing basis. Third party transactions can be based on the Brent crude marker, the Japan Korea Marker (JMM) set for physical LNG sales into Japan and South Korea, Henry Hub based pricing that relates to US pipeline gas prices or even the Japan Crude Cocktail (JCC) marker depending on amongst others the level of appetite for exposure to different regional or commodity price risk.

In conclusion, any method like those described in the draft (quoted price, date of shipment) should not be presented as a presumption that the taxpayer should rebut. Otherwise the burden of proof would shift on the taxpayers whereas those
presumptions would reflect different principles to those used in the pricing of transactions between unrelated parties. Tax administration should start its analysis with the factual elements of the taxpayer (i.e. contracts, uses, etc.).

Consequently, we urge the OECD to carefully consider these aspects in the process ahead.

BUSINESSEUROPE would be willing to engage in a constructive dialogue with the OECD on Cross-Border Commodity Transactions.

On behalf of the BUSINESSEUROPE Tax Policy Group

Yours sincerely,

James Watson
Director
Economics Department
CBI RESPONSE TO THE OECD PUBLIC DISCUSSION DRAFT ON BEPS ACTION 10: TRANSFER PRICING ASPECTS OF CROSS-BORDER COMMODITY TRANSACTIONS

1. The CBI is pleased to comment on the OECD’s Public Discussion Draft on Action 10: The transfer pricing aspects of cross-border commodity transactions (the “discussion draft”).

2. As the UK’s leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

3. The CBI continues to support the BEPS programme to update international tax rules to reflect modern business practice, tackle abusive tax structures and target the incidence of double non-taxation. However, we are concerned that if complexity and uncertainty are not avoided, the outcome will be an increase of double taxation and resulting legal disputes, which could have a substantial and negative impact on cross border trade and investment, but also on tax administrations with limited resources.

Overview

4. The CBI supports the OECD’s work to clarify the use of the Comparable Uncontrolled Price (CUP) method in ensuring that both taxpayers and tax authorities understand that quoted prices do not necessarily represent an arm’s length result for a commodity transaction.

5. We would welcome further guidance where a commodity is traded on a number of exchanges in different jurisdictions where the price may be different in each case. The guidance should confirm that where there is reliable evidence as to the use of a transparent publicly available quoted price, then that price (with the appropriate adjustments) should be accepted even though there may be other quoted prices that are available for use.

6. Guidance on the adoption of a particular pricing date is also to be welcomed. The proposal helpfully sets out that the pricing date adopted by the taxpayer should be followed as long as reliable evidence of the actual pricing date can be provided. However, further guidance on what constitutes “reliable evidence” would be welcome.

7. We would welcome further guidance on what would be appropriate time periods where a fixed period would be acceptable and consideration should be given to providing what would constitute an acceptable fixed time period.
8. A default date that uses purely the shipping date is a gross simplification and would undermine an arm’s length approach. There are many different methods which are used which vary between the commodities traded. It should be made clear that there is only expected to be a very small number of cases where taxpayers cannot justify the date used, in which case, the default date which acts as a last resort should reflect an approach normal for the commodity in question.

9. The discussion draft outlines a number of adjustments for qualitative issues that need to be made to the quoted price to reach an arm’s length result. However, the scope of adjustments needs to be wider to include other issues such as centralised marketing functions and export duties.

10. It is vital that tax authorities increase their knowledge of how commodity markets operate. We fully support the initiative under the Tax and Development programme and that it should be extended to include agricultural products as well.

11. We note that the proposals in the discussion draft do not represent a consensus view. We encourage member states to reach consensus and to engage with non-OECD members to obtain further commitment to a common treatment.

**Detailed Comments**

**A. The use of the CUP Method for pricing Commodity transactions and the use of quoted prices in applying the CUP method**

12. The OECD’s work to clarify the use of the Comparable Uncontrolled Price (“CUP”) is welcomed, ensuring that both taxpayers and tax authorities understand that quoted prices do not necessarily represent an arm’s length result for a commodity transaction. As noted in the discussion draft quoted prices often form the basis for a negotiated transaction but are then subject to a number of adjustments for matters such as transportation and quality differences to arrive at an arm’s length price.

13. The blanket adoption of methods which have no regard to these differentials carries the risk that non-arm’s length prices for transfer pricing purposes are adopted resulting in double taxation or double non-taxation depending on how the relevant commodity market moves. We note that the proposed guidance outlines that adjustments may be required to ensure the CUP method is reliable, however, we would welcome the explicit statement that market quoted prices will rarely result in the arm’s length price unless the pricing terms of the tested transaction are identical to those assumed in the published price.

14. In relation to paragraph 12.2, there may be multiple exchanges that set prices and these may be in different jurisdictions. The paragraph should consider guidance as to which exchange or price setting agency is the most appropriate to use. We have outlined two different examples below:

**Example 1: Agricultural Commodities – Palm Oil**

On the same date, the Malaysian price for palm oil was USD661.25 per ton compared with the CIF Rotterdam price of USD 656.50 per ton. This example is used as Malaysian Crude Palm producers often use the CIF Rotterdam price to determine appropriate prices to European customers. The price difference in this case is not significant but this may not always be the case although it is expected that there would generally be a reasonable correlation between the different exchanges. However if it is considered that the CIF price already includes insurance and freight, whereas the Malaysian price does
not, then the difference becomes more substantial. Especially in the case of large volumes it becomes
important to give guidance as to the most appropriate quoted price to be used.

In addition other factors such as lead times and terms of delivery may result in adjustments that could
narrow the gap. In this case however, the CIF Rotterdam price is generally applicable to smaller
producers rather than the large producers and therefore sales at lower prices are understandable.
Volume related adjustments may be appropriate in respect of the Malaysian price which would result
in a lower price than the quoted price.

Example 2: Liquefied Natural gas

Liquefied Natural Gas (LNG) sold in Asia can be based on a number of different pricing basis. Third
party transactions can be based on the Brent crude marker, the Japan Korea Marker (JMM) set for
physical LNG sales into Japan and South Korea, Henry Hub based pricing that relates to US pipeline gas
prices or even the Japan Crude Cocktail (JCC) marker.

All of these represent a legitimate pricing basis for LNG in the region and are observed between third
parties.

15. The guidance should therefore be expanded to state that where there is reliable evidence as to the use
of a transparent publicly available quoted price, then provided taxpayers use a consistent approach,
that price (with the appropriate adjustments) should be accepted even though there may be other
quoted prices that are available for use.

16. In relation to Paragraph 12.3, a number of qualitative items have been listed that may require
adjustment to the quoted price. Please note our answers to section C of the discussion draft below for
further factors which should be taken into account.

17. In relation to Paragraph 12.4, the greater transparency in the price setting formulas and policy is
supported. As a general comment and in support of the contents of paragraph 7 it is vital that tax
authorities increase their knowledge of how commodity markets operate. The initiative under the Tax
and Development programme should be extended to agricultural products as well.

B. Deemed Pricing Date for Commodity Transactions

18. The adoption of a particular pricing date is also to be welcomed. The proposed language for Section B
in Chapter II of the Transfer Pricing Guidelines helpfully sets out that the pricing date adopted by the
taxpayer should be followed as long as reliable evidence of the actual pricing date can be provided.

19. In relation to paragraph 15.5, there is however no explanation of what reliable evidence means. If a
documented agreement or confirmation notice of the pricing terms (as used in 3rd party transactions is
sufficient) then it would be helpful if this was set out in the Guidelines. The draft guidance goes on to
say that an agreed pricing date can be replaced with a “deemed pricing date” if it is inconsistent with
other facts of the case. There is no guidance as to what these other facts might be. It would be helpful
if the Transfer Pricing Guidelines provided guidance in this area.

20. We also note that that there may exist many different pricing dates in a particular market for a
commodity. In the oil markets, prices can be set based on month average of delivery or prior month
average. Alternatively, prices can be set based on an average of published prices on a set number of
days before or after the date of bill of lading. All of these represent legitimate pricing bases and
although tax authorities (and taxpayers) should not be able to pick and choose in a manner which is inconsistent with arm’s length behaviour, the default position should be that tax authorities should follow the terms adopted by the taxpayer.

21. Finally we would note that the inference within the papers that taxpayers utilise volatile markets to manipulate the transfer price is misleading for a number of reasons. Suppliers of commodities generally do not have the ability to delay production of goods. Logistics are critical to the supply chain. For example, where large goods are being shipped the finalisation of production will be based on tides and shipping times.

22. Currently paragraph 5 stipulates that where a quoted price (appropriately adjusted for comparability) is set and reliable evidence is given that the pricing date and/or time period as agreed has been used, then this should be accepted by the authorities. However, we would also request that further consideration should be given to where pricing may be fixed for a specific period in order to avoid constant price adjustments. For example, where the price for the purchase of a commodity is fixed by the closing price at the end of a specific month for all deliveries in the next month. There may be substantial changes in the price during the month as quoted on the exchanges, but providing this fixed pricing mechanism is followed consistently, both in increasing and decreasing markets, this may be an appropriate pricing methodology.

23. Guidance is however lacking on what would be appropriate time periods where a fixed period would be acceptable and consideration should be given to providing what would constitute an acceptable fixed time period. This time period should be appropriate for the specific commodity and the general terms under which these commodities are traded.

24. The proposed “deemed pricing date” is the date of shipment as evidenced by the bill of lading. The use of one particular date may introduce a level of volatility into the transfer pricing position which may not be attractive to both taxpayer and tax authority. As outlined above, there may be many different methods of determining the pricing date and therefore a last resort methodology should be based on typical transactions for the specified commodity should be used. For example, for oil and gas, average prices around the date of bill of lading might be more representative of an arm’s length transaction.

C. Potential additional guidance on comparability adjustments to the quoted price.

25. Outlined in paragraph 12.3 of the draft guidance are a number of items to be considered for adjustments to the quoted price. From our review, we noted that these tended to focus primarily on qualitative issues. In addition to those listed, we have also identified other potential differentials:

- If sales in the group are conducted through a centralised marketing function, then the adjustments should reflect the functions and risks borne by this company as they will all be included in the transfer price
- Additional duties that producer countries may levy on exports. Again, in our example of palm oil, Malaysia charges export duties, whereas Indonesia does not charge additional taxes.
- In relation to oil and gas, the availability of supply and demand of the hydrocarbons compared with the marker grade
- Further quality differentials include – crude grade, density/gravity and sulphur content (common to oil)
- Common to the gas industry, additional costs include Freight / insurance/ pipeline costs
26. We trust that you will find the above comments helpful in understanding the potential impact of the proposals outlined in your paper. We remain committed to ensuring that each BEPS Action achieves its stated goals, whilst ensuring that genuine business arrangements are not unduly impacted to which this Action forms a key part.

27. We remain at your disposal should you wish to discuss the issues we have raised in this paper in more detail. Please contact neil.anthony@cbi.org.uk for more information.
VIA EMAIL: TransferPricing@oecd.org

February 5, 2015

Mr. Andrew Hickman
Head of Transfer Pricing Unit,
Centre for Tax Policy and Administration
OECD

Re: Comments on Discussion Draft on Transfer Pricing Aspects of Cross-Border Commodity Transactions (BEPS Action 10)

Dear Mr. Hickman:

Thank you for the opportunity to comment on the OECD’s discussion draft on transfer pricing aspects of cross-border commodity transactions (the “Discussion Draft”) as part of the Base Erosion and Profit Shifting (“BEPS”) project.

The Cámara de Exportadores de la República Argentina (CERA) was established in 1943 and it represents the interests of Argentine exporters in multiple sectors whose participation in the country’s 15% ratio of exports/GDP is highly significant.

In Argentina, there is freedom of association and the list of all CERA’s members can be found in Annex II. These include regional and sectorial federations and chambers, exporting companies and cooperatives, and also service providers such as banks.
The Argentine landscape has several unique features:

a) On the one hand, Argentina ranks 45th in the Human Development Index and 47th in per capita GDP worldwide. On the other hand, it places 122nd in regards to private sector credit generation and 68th in capital market capitalization.

b) All products for export have limits placed on their financing's time frame in line with government regulation. For example, a period of 30 days is given for maize, grain sorghum, wheat and petroleum oils. This makes the role of traders essential.

CERA has participated in the national debate surrounding transfer prices, especially the one concerning the “Sixth Method” (2003), and has accumulated valuable experiences. This is why the following presentation is divided in: I) Comment on the Discussion Draft; and II) Annex I – Case study: The Argentine experience.

Should you have any inquiries or doubts, please do not hesitate to contact us.

Very truly yours,

[Signature]

Enrique S. Mantilla
President
CERA’s COMMENT ON THE DISCUSSION DRAFT

I. Introduction

We welcome the application of the arm's length principle to analyze transactions involving commodities. In most discussions with the tax authorities this principle is ignored in favor of the application of other estimates based on assumptions. Therefore, the application of the arm's length principle is a good alternative to avoid the chances of BEPS, as well as possible cases of double taxation.

Particularly, this situation has become more critical in Latin America, where as the exports of primary products represent more than 70% of total exports\(^1\), tax authorities considered that there is a significant potential for BEPS type practices, and this situation led to the establishment of practices not fully in compliance with the arm’s length principle, like the so-called Sixth Method, with different approaches according to each country legislation.

II. General Comments about the Discussion Draft

In order to address one of the main issues about the discussion draft, we agree that the work currently being undertaken on recharacterization and low value-adding services is also relevant in commodity transactions (paragraph 5).

\(^1\) ECLAC, Economic Comission for Latin America and the Caribbean – Statiscal Yearbook 2013. Primary products represented 71,3% of the exports of Mercosur countries, Bolivia and Chile
However, this should not be understood as if any service or transaction with entities outside the country of origin of the goods automatically involves low value-adding service provisions. In this regard, we should remember that for a service to be considered as of low value-adding the following characteristics should be identified:

- To be of an ancillary nature
- It is not the main activity of the multinational group
- It does not require the use or lead to the creation of single and valuable intangibles
- It does not imply assuming or controlling a significant amount of risk

In this context, considering that among the tax administrations’ concerns are the involvement in the supply chain of entities with apparently limited functionality and the application of significant discounts or fees to the commodity producing countries, it is worth noticing that the activities developed by international trading companies do not constitute by default low value-adding activities. In fact, as the draft that proposes amendments to Chapter VII of the Transfer Pricing Guidelines establishes, the activities of sale, distribution and marketing are not to be considered low-value adding activities.

In our experience, fully fledged trading companies (“traders”) play a critical role in the international commodity markets. As economic agents, traders have the function of connecting both operationally and financially the participants of markets with fragmented demand and supply, such as in the case of the agricultural
industry. Traders match the needs of buyers in terms of quality, timing and quantity, with the capabilities of producers and originators of agricultural products.

From the supply side, exporters and originators are mostly dedicated to gathering, storing and elevating grains, oilseeds and its derivatives, resorting to traders in order to place their stocks and to set sale conditions, allowing them to close their economical equations.

Thus, traders must fulfill an intermediation role which has among its main objectives the association of parties and the management of agricultural market risks. Fully-fledged traders activities include:

- Buying from the exporter at the time that they want to sell;
- Selling to the final client or other buyers (distributors, retailers, NGOs, international organizations, purchasing cooperatives, other traders, etc.) when they want to buy;
- Assuming the risks of the agricultural markets (e.g. the fluctuation of prices from the time of the purchase until the buyer demand arises);
- Managing such risks through different instruments that attempt to mitigate them;
- Developing the operational skills necessary to execute their marketing strategies and to fulfill their logistical commitments.

Next, we detail some functions, assets and risks common among traders, which provide a framework to understand the traders’ role in the supply chain.
In what regards to functions, traders engage in negotiations and the conclusion of agreements with clients and suppliers. In many cases, traders also assume all the aspects regarding the logistics of the transactions, from the paragraph they assume the ownership of the goods on the supply end, until the ownership is transferred to the client. These functions require for traders to maintain experienced and knowledgeable staff as well as a network of potential suppliers and buyers, in order to evaluate alternative business opportunities.

Fully-fledged traders may also employ significant assets in the development of their business activities, including:

- **Client / Supplier lists**: Traders maintain and develop a network of clients and contacts to generate business opportunities. They may also employ a network of unrelated sales representatives in the regions where most clients are located. Traders also have a list of potential suppliers that allows them to fulfill their clients' needs on a timely manner when the demand arises.
- **Infrastructure**: Traders control infrastructure (offices or warehousing, when applicable) that allows them to fulfill its international trading functions.
- **Working capital**: Traders have a level or working capital that allows them to maintain buying and selling positions with unmatched credits terms.

Finally, traders add significant value by managing financial, operational and political risks:

a) Traders generally assume and mitigate the following financial risks:
• Price risk: differences in commodity prices between buy and sell dates. The trader may mitigate this risk by matching the quotational periods of buy and sell side transactions, as well as by hedging the risk through derivative instruments.
• Foreign exchange risk, when operating in different currencies.
• Liquidity and interest rate risk, when concluding transactions with different credit terms.
• Credit risk: the trader should assume and monitor the risk that the client may not fulfill its obligations.

b) Traders generally assume and mitigate the following operational risks:

• Counterparty risk: suppliers and clients may not fulfill their contractual obligations.
• Weighing differences between port of origin and port of destination;
• Quality disputes;
• Losses or damages in relation to goods in transit; and/or,
• Unforeseen delays in the loading or unloading of ships.

c) Traders generally assume the following risks:

• Nontariff measures imposed by countries.
• Uncertainty regarding changes in the tax and customs treatment of buy-sell transactions or any of its hedging instruments.
• Uncertainty surrounding public regulation of payment systems.
As described above, fully fledged traders play a role of substantial importance in international commodity markets, which must not be equated to the provision of low value-added services. Additional guidance in this sense might be useful to avoid excessive interpretations of the reference to low value-adding services.

We fully adhere to the statement contained in paragraph 7 of the Discussion Draft. It should be noted that the emergence of the so-called sixth method in Latin America was in part motivated by a lack of deeper understanding of the commodity industry’s dynamic on behalf of the tax authorities, which by default regard traders as unnecessary participants in the supply chain.

III. Proposed additions to Chapter II of the Transfer Pricing Guidelines

a. The use of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method

In relation to paragraph 8, it should be mentioned that the statement “the CUP method would generally be the most appropriate transfer pricing method for commodity transactions” might be interpreted as if there is a preference for methods in the transactions involving commodities. However, the mere existence of quoted prices for commodities does not necessarily guarantee a reliable application of the CUP method, since the conditions of the transaction analyzed and the risks assumed by the parties might significantly differ from the transactions giving rise to the quoted prices, in terms of physical features and the conditions of
the transaction. We consider that the CUP method should be the most appropriate, only provided that: (i) there are uncontrolled transactions, whether the same transactions conducted by the taxpayers with parties, or market prices showing a high grade of comparability with the transaction under analysis (even when these transactions arise from tender processes); and, (ii) it is concluded that such comparable uncontrolled transactions and the CUP method are the most appropriate after having performed the 9 step comparability analysis described in chapter 3 of the OECD Guidelines.

Paragraph 9 of the Discussion Draft briefly mentions the effect of government controls over prices. This paragraph should be further expanded, since despite the fact that the prices informed by government agencies most of the times provide relevant information, which can be particularly useful to eliminate differences between local prices and international quotes, alternative sources should be admitted when it can be proved that they stray from market-set prices, particularly in those cases where official agencies are known to have set or estimated reference prices with the purpose of establishing incentives or disincentives related to their economic policies, rather than to simply report the market value of a product or service.

In addition, more emphasis should be placed on the need to make adjustments to international quoted prices when there are no local reference prices or quotes that can accurately reflect the dynamics of the market in which the transaction actually took place. It should be mentioned also that quoted prices which arise from transparent markets do not generally reflect "the interaction and demand of a certain amount of physical products at a given point in time" as mentioned in the
Organized transparent markets (Chicago Board of Trade, London Metal Exchange, New York Mercantile Exchange, etc.) are futures markets where most positions taken are extinguished by an offsetting position, rather than through the physical delivery of the product. The use of standardized contracts and the possibility of settling an obligation through taking an offsetting position, without delivering or acquiring goods, allows for the participation of agents whose main purpose is to be protected from the variations in the general commodity price level, and who are not interested in selling or purchasing goods of a specific quality at a certain geographical location and period of time. This allows increasing the volume of transactions in organized markets which have a fundamental role in the process of price discovery, but which have little impact on the actual exchange of physical products. The importance of statistical or price reporting agencies in the commodities industry reflect that transparent quoted prices in itself do not provide sufficient information for the purpose of the purchase and sale of physical products.

As mentioned, the price discovered in transparent markets corresponds to a contract under specific conditions and for specific products, and most of the physical transactions between third parties are conducted through the use of pricing formulas, in which the quoted price is considered and adjusted through a premium or discount reflecting the existing differentials between the physical transaction and the underlying contract traded in the market. This is true even for fixed-price transactions, which are very common in the agricultural market, since fixed prices are negotiated taking into consideration the dynamics of the market in terms of quotes, premiums and discounts, at the moment in which the transaction is carried out.
Therefore, unless available official prices or independent prices reported by private agencies for products sold in the same market and under the same conditions as the controlled transaction allow for the use of unadjusted quotes, CUP analyses for commodities should involve the documentation of the quoted prices and the premiums or discounts applied. For the purpose of analyzing the premiums or discounts, the following information should be analyzed:

1. Transactions conducted by the parties involved in the transaction with independent third parties under comparable conditions, where a premium or discount is applied to the quote.

2. There are price reporting agencies or brokers that publish the premiums or discounts applicable to quotes for transactions with certain characteristics (products of a certain quality, delivered in a specific place and under regular conditions).

3. A breakdown of the premium in the different comparability adjustments which in certain cases may be identified and documented with internal information, such as freight paid by the company, quality premiums or discounts identified in contracts with independent parties, etc., or external information, such as market reports on freight prices, typical quality premiums or discounts for non-standard products, etc.

Paragraph 9 also mentions the sources of information. Beyond its illustrative nature, additional guidance should be provided on the use of information which is not always easily available to the taxpayer, or to determine when private information may be reasonable in relation to the quoted price nature of a given
transaction. For this purpose, United States Treasury’s Intercompany Transfer Pricing Regulations Under 482-3(b)(5) provide valuable guidance:

“(i) In general. A comparable uncontrolled price may be derived from data from public exchanges or quotation media, but only if the following requirements are met:

(A) The data is widely and routinely used in the ordinary course of business in the industry to negotiate prices for uncontrolled sales;

(B) The data derived from public exchanges or quotation media is used to set prices in the controlled transaction in the same way it is used by uncontrolled taxpayers in the industry; and

(C) The amount charged in the controlled transaction is adjusted to reflect differences in product quality and quantity, contractual terms, transportation costs, market conditions, risks borne, and other factors that affect the price that would be agreed to by uncontrolled taxpayers.

(ii) Limitation. Use of data from public exchanges or quotation media may not be appropriate under extraordinary market conditions.

It should also be mentioned that there are certain sources of information or market reports, which although are considered by the participants during the negotiation or decision making process, are not highly reliable as regards how the information is
gathered, its comparability (i.e. substitute products or shipments located in distant places), or the frequency of the quotes published, to the extent that they are never used by the participants as markers in their pricing formulas. Making such distinction is important since the definition of commodities provided for in paragraph 12.1. of the Discussion Draft indicates that they will be considered as such those physical products for which a quoted price is used by independent parties in the industry to set prices in uncontrolled transactions. Such definition might be too openly interpreted to consider as commodities physical products for which quotes exist, but such quotes are only marginally used by market participants during the price setting process.

In relation to the comparability adjustments, if their magnitude is such that it may affect the reliability of the CUP method, we deem appropriate the application of other methods either as the primary method applied in the transfer pricing analysis or as a sanity check analysis.

IV. Deemed pricing date for commodity transactions

Firstly, we must clarify what is understood by pricing date. The definition of pricing date becomes particularly important for commodities sale analysis because there may be different dates in which decisions that affect the price are made. For example, one of the most common contracts used in the purchase
of agricultural commodities are forward contracts. In forward contracts, the seller agrees to deliver a certain amount of the commodity in a specific time in the future -commonly, the delivery must take place within a range of dates-. In many cases, the definitive price is set on the date of the agreement (this is known as flat price clause). In flat price forward contracts, it is clear that the pricing date is the date at which the flat price was agreed upon by the parties; thus, the comparability analysis must be performed considering the relevant market data the internal information available at the date of the agreement. However, in other cases, on the date of the agreement the parties do not set a specific price but a formula by which the price will be calculated (this is known as formula pricing methodology). In the formula pricing methodology, the parties agree on a quote that will be used as a reference to fix the final price, as well as on a premium or discount to be applied on that quote (adjusting the characteristics of the quote to the specific conditions of the physical transaction at issue). Forward agreements using formula pricing also establish a quote period (QP) which consists of a range of dates over which the reference quotes will be considered for the purpose of calculating the price. The QP may be fixed (for example, average of the month of January), variable in relation to an observable event (average of the shipping date and the days immediately before and after, or average of the month of arrival), or variable to the decision of the buyer or seller (for example, the QP will be a single day, at the discretion of the buyer, from the date of the agreement until the date of shipment, which should be notified by the buyer to the seller a day in advance). In this type of contracts, there are at least two dates that have an impact on the price: (i) the date when the agreement was executed, in which the conditions of the pricing formulas are established; and (ii) the QP in which the quotes applicable are determined and
the final price is calculated. For this reason, it is of the utmost importance to clarify
the pricing date definition. In our opinion, the comparability analysis should
consider into account the different pricing dates that may affect the transaction. For
example, the comparability analysis of the premiums or discount might be
performed at the agreement date, considering existing market or internal evidence
regarding the arm’s length nature of such component of the price at that point in
time, while the individual quotes employed in the calculation should be instead
analyzed in relation to the QP.

In paragraph 13, reference is made to the existence of significant evidence as
regards that commodities tend to be "priced by reference to the quoted price within
a quotation period close to the time of shipment". Such statement seems to be of
importance to consider the time of shipment as a substitute pricing date in the
absence “reliable data”. In our experience, even though there might be evidence
that in some cases commodities tend to be priced by reference to the quotation
period close to the time of shipment, there is also significant evidence to the
contrary. In fact, in international physical trading of commodities, the use of forward
agreements is most usual. Forward agreements are usually arranged weeks or
months in advance of the shipping date. Even in the case of formula pricing
forward agreements in which the QP is defined as a range of dates close to the
shipping date, it should be bore in mind that the QP is not a period in which the
conditions of the agreement are set, and, therefore, it should not be considered as
the period over which the comparability analysis should be performed. In any case,
the comparability analysis should be based on the actual conditions of the
transactions under analysis, and not on generalizations regarding market practices.
By way of example, in the oilseed crushing industry, forward contracts are usually entered into with a fixed price and those contracts may be entered into weeks or months in advance to the date of shipment. This is due to the fact that the oil industry obtains its return from the crushing margin existent between the purchase price of commodities used as input (soy, sunflower, corn, etc.) and the commodities produced from its transformation (oil and flour). Commodities used as raw material are acquired from producers generally at a fixed price, and during the time it takes for the transformation process to be completed, the general commodity price level may be reduced, scenario under which the realization value of by-products would be lower than the cost of the inputs. For this reason, as inputs are purchased, oil companies must close their economic equation. One of the most common tools to do so is actually entering into forward agreements at a fixed price as long as the inputs are acquired, and, as mentioned, this may be made in advance to the shipment date.

In this context, if the shipment date is used as the "deemed pricing date" in exchange of the actual pricing date (which, as we have described before, may be more than one depending on the type of agreement), inexistent income may be taxed within a scenario of price rises in the case of an exporter, or drop in prices in the case of an importer. It is worth mentioning that, even in transactions whose pricing date is close to the time of shipment, the short term price volatility that characterizes commodity markets may give rise to the taxation of notional income and double taxation, if such “close” time gap is ignored. This would be worsened by the fact that in many countries, such as in Argentina, differences between the controlled price and the comparable uncontrolled price are only computed provided that they generate a tax loss.
In this way, we should not consider bill of lading dates as valid substitutes for the pricing date under the arm's length principle. For this reason, it is extremely important to clarify the concept of "reliable evidence", mentioning for example the involvement of notary publics in the documentation of the transaction or the registration of contracts entered into by the parties with official agencies should be sufficient elements. The experience in Latin America (Uruguay, Paraguay) shows that the creation of an official registry for agreements (Registro de la Cámara Mercantil de Productos del País in Uruguay\textsuperscript{2}, Registro de Contratos de Exportación in Paraguay\textsuperscript{3}), through which key elements of their operations are informed to the local authorities, can provide further information regarding industry practices and therefore greater credibility to the analysis carried out by tax payers.

Also in this sense, the addition of the concept of "inconsistency with other events" generate doubts as to the application of the "deemed pricing date". For example, in case of a contract duly registered, where there are no doubts as regards the conditions and price at the contract date, would the shipment date be applied in the case of differences with other transactions conducted by the exporter that may differ in different aspects like destination, quality, opportunity, preferences, among others? Clarifying the concept of inconsistency is relevant to avoid leaving the possibility of subjective interpretations open stating that, in any case, the use of the “deemed price date” is a method of last resort. Considering the experience in Argentina, local law has defined a method regarding traders whose practical

\textsuperscript{2} Resolution 2269/009, December 30, 2009
\textsuperscript{3} General Resolution 31/14; July 14, 2014
application has raised doubts as to how to calculate the ratios involved, and therefore generating confusion in taxpayers⁴.

In these cases, it would also be important to mention that in the case the deemed price is applied, it should be applied to all cases (whether the price at the shipment date is lower or higher than that of the contract date) to minimize eventual cases of double taxation.

**ANNEX I - Case Study: The Argentine experience. The Sixth Paragraph Method (MSP)**

In the 2003 tax reform (Law 25.784), it was included a new methodology to be applied in the case of exports to related entities for grains, oilseeds, other land-related products, hydrocarbons and their by-products, and in general, goods with

⁴ As described in Annex I, Income Tax Law provides that the Argentine “sixth method” shall not apply to the extent the international trader satisfies a three-prong test:

(a) it has actual presence in its territory of residence, with commercial premises for the administration of the business, and compliance with the legal requirements of organization and registration and reporting of financial statements. The assets, risks and functions undertaken by the international trader should be consistent with the volumes of the transactions conducted;

(b) the international trader’s main activity does not consist in obtaining passive income, nor in the intermediation of commodities from and to Argentina or with other members of the economically related group; and

(c) the trader’s international trade transactions with members of the same economic group should not exceed thirty percent (30%) of the annual aggregate transactions concluded by the international trader.
known prices in transparent markets handled by an international intermediary who is not the actual receiver of the goods. In such case, the best method to determine Argentine source income from the export will be the market price in force at the date goods are loaded —whatever the means of transportation— without considering the price that would have been agreed upon with the international intermediary.

However, if the price agreed with the international intermediary were to be higher than the market price in force at the date of loading of the goods, the first of them will be considered for tax purposes. This criterion creates a significant tax burden for companies engaged in forward sale contracts with fixed prices or with future-linked prices whose quotation period differs from the bill of lading date, then, upward movements in market quotes after the signing of contracts will result in significant tax adjustments that cannot be compensated by opposite adjustments when quotes fall after the agreement date.

Sub-paragraphs (a), (b) and (c) of the eighth paragraph of Article 15 of the Income Tax Law (ITL), establish the requirements that must be met by the international intermediary (“ABC requirements”) for the MSP not to be applicable to the exports transactions with that person:

The intermediary must have an actual presence and a commercial establishment in the territory of residence from where its business is managed, and to meet the legal requirements regarding incorporation, registration and presentation of financial statements. The functions, assets and risks assumed by the international intermediary should be consistent with its volume of business;
Its main activity should not consist in obtaining passive income or to intermediate in the sale of goods to or from Argentina or with other members of its economic group; and

Its international foreign trade transactions with other members of the same economic group may not exceed 30% of the overall annual transactions carried out by the foreign intermediary.

Decree 916/04 of the Argentine Executive Branch regulated various aspects of the amendments introduced by Law No. 25,784, mainly those relating to the requirements to be met by international intermediaries.

The most important aspects of the Decree 916/04 in relation to our analysis are:

(i) “… the reform introduced a new method for determining the Argentinean income source, whose main purpose is to provide to the tax authorities a tool that allows to neutralize in an agile and fast way, operations in which, through the interposition of international intermediaries, the profit attributable to that source from the export of goods with known prices in transparent markets is relocated" -fifth paragraph of the Recitals-.

(ii) "... the new method comprises those cases where the exporter makes the transaction with or through an international intermediary whom, besides of not being the actual recipient of the goods, does not comply with the requirements previously mentioned"- seventh paragraph of the Recitals -.

In relation to points (i) and (ii) above mentioned it can be observed, first, that the Decree refers only to the operations of export of goods that have known prices in
transparent markets, even though the ITL expresses the possibility of extending
the application of the MSP to other goods to the extent that the export is made
between related parties though an international intermediary.

On the other hand it emphasizes the application of the MSP when goods are
exported to an international intermediary other than the effective recipient of the
goods. By “effective recipient” it refers to the subject that receives the goods.

The aforementioned Decree 916/2004 also incorporated the following text to the
RD: "For purposes of applying the method provided in the sixth paragraph of Article
15 of the law, all export transactions in which an international intermediary who
fails to comply the requirements in the eighth paragraph thereof, are considered
not to be arm's length or under the normal market conditions referred to in the third
paragraph of Article 14 of the law."

In addition, in relation to the analysis that must be held to apply the MSP, the
Decree 916/2004 established the following:

"The information to be considered in relation to subparagraphs a), b) and c) of the
eighth paragraph of Article 15 of the Act, is that of the fiscal year the exporter is
paid. If the fiscal year end date of the international intermediary does not coincide
with that of the exporter, the information to be considered is that of the last fiscal
year of the international intermediary prior to the exporter's fiscal year end, despite
which, when the tax authorities deems justified, annual information of the
intermediary covering the same period of the exporter's fiscal year may be
required. "

"According to the provisions of the sixth paragraph of Article 15 of the Act, by market value on transparent markets at the loading date of the goods, it refers to the quote at the day the load is concluded. When the transportation of the merchandise is made by unconventional means or other special situations arise, the tax authorities shall determine standards to be considered in establishing the above criteria.

"The proof of the accreditation of the requirements under sub-paragraphs a), b) and c) of the eighth paragraph of Article 15 of the Act, must be based on sound and concrete accreditations, lacking of virtuality any general appreciation or reasoning grounded on general foundations. For the purpose of calculating the said paragraph b) passive income shall be considered as defined in this regulation."

"Also, to establish whether the main activity of the international intermediary is the marketing of goods from and to the Argentinean Republic, the purchases and sales to the intermediary should be related to the total purchases and sales of such intermediary."

"In turn, for calculating the percentage referred to under subparagraph c) the total income and expenses -accrued or perceived- in operations with the remaining members of the same economic group must relate to the total income and expenses -accrued or perceived- by the intermediary, net of income and expenses from transactions with the local operator of the economic group concerned."

In conclusion, Decree 916/04 regulated certain aspects in relation to the methodology of calculation of the ABC requirements –however still leaving open to
interpretation certain aspects regarding the computation of ratios that will be later discussed--; determined that the proof must be based on reliable and specific documents, lacking of any value ungrounded appreciations or justifications; and, finally, it clarified that the market value in transparent markets for the day of loading of the goods means the quoted price at the day the load is concluded.
ANNEX II – CERA’s members

Institutions

Asociación de Cooperativas Argentinas (ACA)

Asociación de Productores, Empacadores y Exportadores de Ajo, Cebollas y afines de Mendoza

Cámara Argentina de Bases de Datos y Servicios en Línea (CABASE)

Cámara Argentina de Fructosas, Almidones, Glucosa, Derivados y Afines (CAFAGDA)

Cámara Argentina de Fruticultores Integrados (CAFI)

Cámara Argentina de Productores Farmoquímicos (CAPDROFAR)

Cámara Argentina del Acero

Cámara Argentina del Libro (CAL)

Cámara Argentina del Maní

Cámara de Armadores de Poteros Argentinos (CAPA)

Cámara de Comercio Exterior de Cuyo Mendoza

Cámara de Comercio Exterior del Chaco

Cámara de Comercio Exterior de Misiones (CACEXMI)

Cámara de Comercio Exterior de Salta

Cámara de Comercio Exterior de San Juan
Cámara de Comercio Exterior del Centro Comercial e Industrial del Dpto. Castellanos – Santa Fe

Cámara de Comercio, Industria, Agricultura y Ganadería de Gral. Alvear – Mendoza

Cámara de Exportadores de Rosario

Cámara de Industriales de Productos Alimenticios (CIPA)

Cámara de Industriales Ferroviarios de la República Argentina (CIFRA)

Cámara de Procesadores y Exportadores de Maíz Pisingallo (CAMPI)

Cámara de la Industria Curtidora Argentina (CICA)

Cámara de la Industria del Calzado (CIC)

Cámara de la Industria Pesquera Argentina (CAIPA)

Cámara de la Industria Química y Petroquímica (CIQYP)

Cámara Industrial de Laboratorios Farmacéuticos Argentinos (CILFA)

Centro de Empresas Procesadoras Avícolas (CEPA)

Centro de Exportadores de Algodón de la República Argentina

Centro de la Industria Lechera (CIL)

Consortio de Exportadores de Carnes Argentinas

Federación Argentina del Citrus (FEDERCITRUS)
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Asociados Don Mario SA
Atanor SCA
Automacion Micromecanica S.A.I.C.
Autosal S.A.
B & B Consultora S.A.
Bactssa Terminal 5 Buenos Aires
Container Terminal Services S.A.
Bamenex S.A.
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Banco de Galicia y Buenos Aires S.A.
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Banco de la Provincia de Buenos Aires
Banco Santander Rio
Bandex S.A.
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Basso S.A.
Baterias Argentina SA
Bayer SA
BBVA Banco Frances S.A.
Becher y Asociados SRL
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Bic Argentina S.A.
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Bio Sidus S.A.
Bioprofarma SA
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Bolland y CIA SA
Bremen Oil S.A.
Bridgestone Firestone
Mahle Argentina SA
Mai S.A.
Maiz Pop SA
Malteria Pampa SA
Manuel Sanmartin S.A.I.C.
Manufactura de Fibras
Sinteticas S.A. (Mafissa)
Manuli Packaging Argentina S.A.
Masisa Argentina S.A.
Massalin Particulares S.A.
Mastellone Hermanos S.A.
Materia Hnos. S.A.C.I.F.
MC Cain Argentina S.A.
Medix I.C.S.A.
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Minera Santa Cruz SA
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Molino Cañuelas Sacifia
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Moto Mecanica Argentina S.A.
Multigrain Argentina S.A
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Newport Cargo S.A.
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Nutrin S.A.
Offal Exp S.A.
Olega S.A.C.I.
Omnimex S.A.
Omsr S.A.
Organizacion Coordinadora Argentina SRL
ARGENTINA S.A.I.C.
BRUCHOU, FERNANDEZ MADEiero &
LOMBARDI ABOGADOS
BUNGE ARGENTINA SA
C. STEINWEG HANDELSVEEM
(ARGENTINA) S.A.
CARBOCLOR S.A.
CARBONEX S.A.
CARGILL S.A.
CARMEN F. CARBALLEIRO
CCI - CONSULTORES DE COMERCIO
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COMMERCE EXTERIEUR)
COMPAÑÍA ARGENTINA DE
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INDUSTRIA BASICA S.A.
BEPS ACTION PLAN 10: Comments on the Discussion Draft on the Transfer Pricing Aspects of Cross-border Commodity Transactions

To: Mr. Andrew Hickman (TransferPricing@oecd.org)
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development

From: Cámara de la Industria Aceitera de la República Argentina – Centro de Exportadores de Cereales (CIARA-CEC) / Contact Person: Mr. Cristian E. Rosso Alba (crossoalba@rafyalaw.com).

Date: February the 4th, 2015
RELEVANT INFORMATION ON CIARA AND CEC AND ITS MEMBERS, AS WELL AS ON THEIR ECONOMIC SIGNIFICANCE TO THE ARGENTINE ECONOMY.

Dear Mr. Hickman,

CIARA-CEC -the Argentine Chamber of Grain and Oilseeds Exporting Companies- is pleased to provide comments on the OECD’s Discussion Draft on *Transfer pricing aspects of cross-border commodity transactions* related to Action 10 of the BEPS Action plan. We welcome the proposal to include additional guidance on the application of transfer pricing rules on cross-border commodity transactions, in light of the specific features of such transactions. Due to the broad application of the so called “six method” to the largest exporters of grain and oilseed commodities in Argentina, our members have been exposed to the topics under discussion over the last ten years. Lessons learned comments to the discussion draft and experiences are hereby elaborated, for the benefit of the OECD and the worldwide community, with the common aim to help developing sound tax policies for a better world.

Argentina is a major food producer at a worldwide level. In 2013, Argentina was the first world exporter of soybean oil (68% of the world total), soybean meal (52%) and sorghum (46%); second world exporter of peanut oil (28%), peanut meal (12%) and barley (13%); third world exporter of soybean (9%), corn (20%), sunflower oil (9%) and sunflower meal (9%); and, eighth world export of wheat (5%). The Argentine oilseed complex is one of the largest and most efficient industrial clusters in the world, with investments of more than USD 2 billion between 2004 and 2012. Moreover, the Argentine oilseed agribusiness production reaches more than 100 destinations all over the world. The sector employs over 28,000 workers directly, and more than 200,000 indirectly. The grain and oilseed complexes contributed jointly with 37% (30.4 billion dollars) of the country exports in 2013.

CIARA and CEC, through its associated companies, represent the 90% percent of the oilseed and grain export sectors. Both entities have consistently participated in the Congressional debates on transfer pricing issues, especially the one concerning the “sixth method” (October, 2003). Most of the technical viewpoints then mentioned to the Argentine Congress are now elaborated in the paper attached; further enriched by more than ten years of experience in this field. For more information about CIARA and CEC please see [www.ciaracec.com.ar](http://www.ciaracec.com.ar), English version. All the associated members can be found in Annex II.

Given the importance of transfer pricing issues for our associates and their remarkable contribution to the Argentine economy as a whole, CIARA and CEC –as representative of a significant number of affected entities- want to express their willingness to participate in the Discussion Draft public consultation process, to be held on March 19-20 2015, so as to provide further explanations and/or clarifications as to the commentaries which follow.

Should you have any inquiries or doubts, please do not hesitate to contact us.

Kind regards.
On implementation of policies framed under BEPS Action Plan N° 10 – Transfer Pricing Aspects of Cross-Border Commodity Transactions- policy makers shall capitalize the experience accumulated by Argentine taxpayers since the adoption of the so called “sixth method”, back in 2003.

Argentina provides a unique practical example of the dynamics of its application and, specially, of the recurrent tension with traditional transfer pricing methods. The main drivers for this novel methodology triggered yet unanswered tax policy questions, starting with the actual need for an alternative methodology when the CUP addresses properly every single tax policy concern at stake (for further elaboration, see Annex I, “The Argentine Experience - Background and Lessons Learned”). Accordingly, the clarification proposed in the Discussion Draft to Chapter II of the Transfer Pricing Guidelines as to the sufficiency of the CUP method is shared by this commentator.

The commodities’ international supply chain reflects the existence of value-adding services in countries beyond the sourcing one. The Argentine “sixth method” disregards proper income allocation to those countries where the hedging, distribution, marketing and commercial financing functions, among others, take place. This much, in turn, results in a source of unresolved international double taxation, compromising value creation on those tranches of the supply chain beyond origination.

The Argentine “sixth method” also poses a conflict with arm’s length pricing standard since (i) it disregards the mechanics of price determination by unrelated parties; (ii) it is mandatorily applied and provides reduced room for comparability adjustments; (iii) it compromises futures markets; (iv) it is based on an arbitrary determination of the pricing date (relying on the higher price between the contract date vs. shipment date); and (v) it brings uncertainty about the final price for the local exporter, as it is a volatile market.

The dynamics of the “sixth method” in Argentina further illustrates that -though initially conceived as an exceptional anti-avoidance rule-, it soon became a prevalent methodology aimed at improving revenue collection. This outcome stemmed from the inclusion of a controversial substance test and a broad definition of “affiliated party”, which includes any trader that does not meet such thorny standard. As a consequence, most large commodities exporters are facing tax controversies on this regard, leading to an unprecedented level of uncertainty for the industry. Furthermore, while Customs value is clearly set on the contract date under Argentine law, the “sixth method” takes away such certainty, by paving the way for an adjustment of the commodity price in view of listed prices on the shipment date. This much compromises value creation as well.

Next follows our paragraph-by-paragraph comment on the Discussion Draft:
The comments that follow next, grouped by numbers, correspond to the paragraph numbers of the Discussion Draft

1. Since developing countries are heavily dependent on the commodity sector to improve employment, revenue, income growth, balance of payments and foreign exchange reserves, a sound tax policy is essential to preserve both economic efficiency and the international competitiveness of domestic firms.

2. The diagnosis of BEPS in cross-border commodity transactions should be scrutinized in view of the remedies existing in domestic legal frameworks, which would determine whether it is necessary or not to produce general amendments to Chapter II of the OECD Transfer Pricing Guidelines, like the ones proposed in points 12 and 15 of the Discussion Draft.

Many countries -like Argentina- do require contemporaneous filing of the main elements of the export agreements with the Government, thus making the adoption of a *deemed pricing date* unnecessary. Public registries close the room for maneuvers to get the most advantageous quoted price.

The same conclusion applies with regards to the additional guidance proposed so as to use quoted prices under the CUP method, provided that comparability adjustments are properly made. In the Argentine context, the use of quoted prices, adjusted by local-market premiums, results in actual “domestic” CUPs, daily assessed, which are commonly used both by the tax authorities and the taxpayers. In tax controversy practice, the uncertainty created by the “sixth method” is not a consequence of the lack of adequate pricing information, but rather of the arbitrary power -granted to the Argentine tax authorities- to pick up the higher price in two different moments in time (sometimes as distant as a complete year). This outcome does not occur under the “six method” as regulated under the law\(^1\) in Uruguay: in the presence of an “unsubstantiated” trader, all transactions have to be

\(^1\) Law 18.083, Section 43, first paragraph, *in fine.*
revalued on the shipment date exclusively, regardless of the price agreed on the contract date. Tax laws should be designed in a consistent way, so that if a re-characterization is made on the shipment date, it should apply with all of its associated consequences (i.e. whether it favors or not the revenue outcome).

The “sixth method” has been also justified as a tool to avoid base erosion at source-country level. It is noted that this outcome derives from affiliated companies charging significant fees for intra-group services, despite their apparent limited functionality. This concern could be tackled with the traditional transfer pricing methods, without a need for presumptive taxation (i.e. the “sixth method”) being enforced. In fact, limited assets, risks and functions in the supply chain after the source country merit a null or limited allocation of worldwide income. Hence, the arm’s length principle needs not be sacrificed by the “sixth method”, which compromises international tax consistency in a world of multiple tax systems. The Argentine experience shows that the most affected parties are exporters required to cope with international double taxation. This outcome got aggravated over time, due to the lack of effective action by competent authorities and the permanent refusal of the tax authorities to agree on international tax arbitration and other tax controversy solutions (addressed at BEPS Action Plan 14).

3. This commentator further agrees that the CUP method may achieve a thorough reduction in the incidence of BEPS, while minimizing international double taxation. Conversely, the Argentine “sixth method” has been consistently challenged at Courts for compromising international Double Tax Conventions that follow the OECD Model Tax Convention.

Only the CUP method is compatible with the arm’s length principle, thus being lined up with Section 9 of the OECD Model Tax Convention. On the contrary, the Argentine “sixth method” disregards the mechanics of price determination by unrelated parties, who never determine prices in two different moments in time materially distant one from the other. Secondly, the “sixth method” provides for reduced room for comparability adjustments and compromises futures markets. Third, it means that the source country takes over a larger
share of taxable income, picking up the upside (and only the upside) of commodities’ price volatility from the contract date until the shipment date. Meanwhile, hedge costs are left with the group counter-party purchaser, as well as any price downside. International double taxation is inevitable in such a scenario.

6. In order to ensure that “pricing efficiently reflects value creation”, special attention shall be drawn to the specific value-adding functions that traders and other intermediaries perform in the supply chain, which have to be remunerated at arm’s length conditions. An express recognition of the role of value-adding intermediaries shall be included in the Guidelines, so as to properly preserve value created in each tranche of the supply chain.

International tax voices unanimously agree that unsubstantiated intermediaries shall be looked through, so as to avoid the proliferation of abusive triangular arrangements aimed at the artificial shifting of income. This consensus, however, cannot be extended to encompass all intermediaries, as they play an essential role in the marketing of commodities. Intermediaries holding relevant functions and bearing transactional risks, while exposing their own assets, shall be remunerated accordingly.

International commodity-trading companies play a key role in the management of global trading and marketing activities, as they assume relevant risks and hold significant functions in the supply chain. Their activities do add significant value to the sector’s business and should merit a profit allocation commensurate to such risks and functions, so that each country where a key person of the commodity supply chain is located does get its proper share of the worldwide taxable income.

Traders consolidate sources of supply so as to meet customer demand, efficiently addressing market concerns, such as seasonal asymmetries and supply chain instability. To this extent, they manage price volatility risks, undertaking major hedge functions and undertaking the associated risks. At the same time, they manage logistics, assuming the
risks inherent to such function, and aiming at optimization of haulage and control costs. By freight swapping, significant savings on transportation can be made.

Intermediaries also target time-related inefficiencies, such as price and currency fluctuations, political and economical turbulences and customs and financial risks. They guarantee their customers a permanent supply of commodities, many times at short notice, reducing disruptions in the value-adding chain.

Additionally, a thorough analysis of the functions of intermediaries in cross-border commodities transactions cannot oversee the fact that “the multinational companies may be subject to conflicting governmental pressures in various jurisdictions where they have operations. These pressures include customs valuation, anti-dumping policies, overseas remittance restrictions, foreign exchange controls and, of course, transfer pricing enforcements”\(^2\). These factors –quite material in developing countries- increase the need for international traders, centered in major global hubs, which cushion regulatory risks existent in commodity-source jurisdictions.

7. Acknowledgment of commodity markets and business commercial practices by national tax agencies is essential so as to protect the international competitiveness of each country’s economic players. Conversely, a lack of consideration for these practical issues may hinder the market’s normal functioning, affecting employment, capital formation rates and other economic indexes and triggering inter-jurisdictional tax conflicts. International double taxation created by the “sixth method” ends up hindering cross-border trade in developing countries, which are in a crucial need to improve direct investment to expand its economies.

8. This commentator agrees that the CUP method is certainly the most appropriate transfer pricing method for commodity transactions\(^3\), as it generally provides a clear standard for determining arm’s length conditions. Scholars regard it as being “the most direct and reliable way of testing and documenting arm’s length pricing”\(^4\), conclusion shared by both the OECD Guidelines\(^5\) and US transfer-pricing Regulations\(^6\).

In addition, the Argentine experience conveys the following material conclusions as to this point 8:

(i) the compatibility of quoted prices with the CUP method, as the former could be properly adjusted for comparable purposes, and

(ii) The possibility of comparability adjustments on quoted prices, so as to make them suitable as “domestic” CUPs. Transparency in this information led to the daily publication of agri-commodity listed prices by the Argentine government, in a database commonly used by both tax authorities and taxpayers.

Hence, the CUP method, applied to its full extension –and enriched by all the necessary comparability adjustments (specially when determined by reference to a quoted price)- proves to be a comprehensive tool for determining transfer prices in commodity transactions, without compromising the arm’s length standard. For instance, the sole application of general rules\(^7\) to a triangular related-party transaction in which the

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\(^3\) Provided enough information is available for benchmarking purposes.


\(^5\) OECD Guidelines, Paragraphs 2.5 and 2.7.

\(^6\) US Regulations, Section 1.482-1(c) (1).

\(^7\) In such sense, BISCHHEL and FEINSCHREIBER assert that “The substance over form principle is also applied to particular transactions that may be disregarded if their primary purpose is tax avoidance (...). The substance over form doctrine is similar in scope to two other judicially-created doctrines. Sham transactions will be disregarded, and transactions without a business purpose will not be given their intended effect”. Fundamentals of International Taxation, 2nd edition, Practising Law Institute. New York City, 1985. P. 284
intermediary lacks substance would lead to its disqualification; provided arm’s length conditions were actually absent.

10. Comparability adjustments are required on quoted prices so as to turn them into reliable CUPs, since it is essential to take into consideration, among other factors, differences in product quality, traded volumes, market share, pricing dates, cost structures, insurance and freight, market conditions, contractual terms, macro-economic context (including foreign exchange effects), domestic premiums or differentials, financing costs, assumption of risks, as well as value-adding functions provided by other affiliated companies in the supply chain.

12. This commentator consequently agrees with the following proposals: (12.1) Appropriateness of the CUP method, taking into consideration that its construction out of quoted prices makes it necessary to perform comparability adjustments to resemble uncontrolled transactions; (12.2) Governmental price-setting agencies, which gather information as to domestic differentials, premiums and standard adjustments, are certainly helpful, provided that the CUPs elaborated by these agencies do resemble unrelated party outcomes; (12.3) Quoted prices used to benchmark related-party transactions should involve commodities which are essentially similar in physical features and quality. Adjustments for traded volumes, timing, transactional terms and conditions, quality and availability premiums, costs, insurance and foreign currency terms, among others, should be properly considered; (12.4) The need for group companies to assist tax authorities in reporting and examining transfer pricing practices, as it is done in Argentina by means of annual transfer pricing reports as well as six-month summarized reports filed by taxpayers.

13. This commentator would like to clarify his criterion as to the scope of the statement included in paragraph 13 of the Discussion Draft, which states that there is “considerable evidence” (sic) that commodity transactions generally tend to be priced by reference to the quoted prices, within a quotation time period close to the shipment date. Many times tax authorities wrongly understood that unrelated parties would price “close to the time of
shipment”, while affiliated parties would not. In fact, this thesis was brought by the tax authorities to the Argentine Courts, tested with unrelated parties' behavior, and finally decided unsuccessfully for the tax authorities. Actually, commercial circumstances around each transaction, relative positions held by each trader and risk-undertaking policies do govern; and could merit –in different periods of time and for different transactions- divergent pricing policies, in view of the trader’s needs, supply and demand for each commodity and worldwide market trends. Futures and spot sales (for close delivery) are commonly present in commodities’ markets -both in related and unrelated party scenarios- and each of them should be priced accordingly, by pondering their unique economic circumstances.

14. The use of a deemed pricing date shall be interpreted restrictively and limited to exceptional cases, where the lack of reliable evidence is unquestionable, thus closing the room for vague interpretation as to what “reliable evidence” means in practice. As a result, technically speaking, the introduction of a deemed pricing date shall be construed as a General Anti-Avoidance Rule, only applicable as a last resource.

To tackle the inexistence or unreliability of evidence regarding the contract’s actual pricing date, the introduction of relevant contract filing mechanisms should be considered. Contract registration –either before an administrative authority or a non-governmental agency- would undoubtedly provide a certain date for pricing purposes, reducing market uncertainty and eliminating the practical need for a deemed pricing date.

Latin American countries possess some relevant experience in contract filing. Argentine legislation, for instance, requires exporters to inform commodity cross-border transactions for trade regulation purposes to a special unit of the Ministry of Agriculture –i.e. the “UCESCI”-. The update and enhancement of this mechanism with relevant pricing information, adapting it to suit transfer pricing requirements, may prove an efficient alternative.
Uruguay has introduced in recent years a tax-specific contract filing mechanism, with the participation of a private entity –i.e. the “Cámara Mercantil de Productos del País” (Chamber of Commerce and Export of Agriproducts). Such filing gives certainty not only as of the date of execution of the contract, but also as regards its whole content, while avoiding the considerable costs which notarial intervention entails. Similar provisions have been later adopted by Paraguay and Guatemala.

We consider Uruguay provisions may be adopted as a consensus solution to this issue, as they would provide national tax agencies with an efficient tool for tackling commodities’ pricing date concerns while reducing tax uncertainty, which hinders value creation processes.

15. This commentator agrees with proposed paragraph 5, as it stresses the importance of the pricing date chosen by the parties, provided that there is reliable evidence of such date. Conversely, the mandatory application of the “sixth method” compromises the arm’s length standard since it resorts to two different pricing dates just to improve tax collection, namely by picking the highest price. While the government justifies its application in presence of an unsubstantiated trader, it prevails from the criticized outcome by picking up the price on the contract date whenever the quoted prices on the shipment date are lower\(^8\).

Appealing to the shipment date as a deemed pricing date should be regarded as a last resource, and governments should be encouraged to set up public registries to file export agreements contemporaneously with their execution, so as to tackle this concern with transparency. In all cases, transfer pricing outcome shall ensure proper comparability adjustments, especially when the CUP is construed out of quoted prices.

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\(^8\) Such outcome of the “sixth method” has been criticized for violating the principle of exemplarity of the acts of government, which requires the acts of government to be public, frank, law-abiding and coherent with previous manifestations of governmental power. This principle has been endorsed by the Argentine Supreme Court case law in re “Aerolíneas Argentinas S.E. vs. Buenos Aires”. Fallos 308:2153. Available at [http://www.csjn.gov.ar/jurisp/jsp/fallos.do?usecase=mostrarHjFallos&falloId=91130](http://www.csjn.gov.ar/jurisp/jsp/fallos.do?usecase=mostrarHjFallos&falloId=91130) (official Spanish version).
16. Comparability adjustments for assessing a reliable CUP require to compare, and adjust, the following factors: type and quality of the goods being compared; differences in traded volumes; market share; pricing dates; cost structures; insurance and freight; market conditions; contractual terms (including payment terms); macro-economic context (including foreign exchange effects); domestic premiums or differentials; financing costs; assumption of risks; functions performed, as well as value-adding functions provided by other affiliated companies in the supply chain.

Annex I: The Argentine Experience. Background and Lessons Learned

a. The “sixth method” in Argentina: Law 25784 and its Implementing Decree

Since there is not a single “sixth method” in Latin America, it is important to frame the Argentine normative context. Section 15 of Argentine Income Tax Law (“ITL”) generally provides for the arm’s length standard to determine transfer prices between affiliated companies. The provision adds –in line with OECD Guidelines- that in order to determine such prices “the most appropriate method will be used according to the type of transaction made.” For such purposes, the methods originally established by law were the Comparable Uncontrolled Price, Resale Price, Cost-Plus, Profit-Split and Transactional Net Margin Methods.

In addition, the tax framework gets completed by means of set implementing decrees. Such regulations set forth that comparable transactions are those in which there are no differences affecting the price, profit margin or consideration amount or when such differences can be eliminated through adjustments that allow for a substantial comparability (Section 21.2, ITL implementing decree). Section 21.5 allows the utilization of the interquartile range and the median, as proper statistical measures.

In this context, Law No. 25,784 became effective on October 22, 2003. Among other relevant changes, it substantially modified the preexistent transfer pricing framework by incorporating the so-called “sixth method” to the ITL Section 15.

ITL Section 15, sixth paragraph, as amended, states that “Exports made to affiliated parties, of cereals, oilseeds, other crops, hydrocarbons and their derivatives and, generally, goods with listed prices in transparent markets, executed with the intervention of an international intermediary which is not the effective acquirer of the goods” shall be valued at the higher of

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9 For more background as to this reform, see Rosso Alba, Cristian E.: “An Inside Look at Argentina’s Tax Reform on Transfer Pricing”, Practical Latin American Tax Strategies, WorldTrade Executive Inc., Volume 6, number 12, page 1.
the following two prices (i) the “listed price of the goods at the date in which the merchandise is shipped” or (ii) “the price agreed with the international intermediary”.¹⁰

ITL Section 15, eighth paragraph, sets forth some requirements that, if met by the international intermediary, exclude the transaction from the “sixth method”. Briefly, such requisites –named the “ABC” test, in tax practice- are:

(a) that the foreign intermediary should bear real presence in the territory where it is a resident, and that its assets, risks and functions should be commensurate to the volume of its transactions,

(b) that the foreign intermediary’s main activity should not be the accrual of passive income, nor the intermediation in the commercialization of assets to and from Argentina or amongst other members of the same affiliated group of companies, and

(c) That international commercial transactions with companies belonging to the same affiliated group should not exceed an amount equivalent to 30 percent of the aggregate volume of the operations concluded by the international intermediary.

The rationale of the “sixth method” –as enacted by Congress- was crystal clear: when an Argentine exporter of commodities were to sell to a related party located abroad through an “unsubstantiated” intermediary (i.e. the one who does not meet the ABC test), then the “sixth method” did apply. Three parties were thus necessary: affiliated export and purchaser companies, and an unsubstantiated intermediary.

To ease audit procedures, implementing regs compromised the previous legal standard. They state that whenever an Argentine exporter were to export commodities to an “unsubstantiated” foreign purchaser, the “sixth method” would apply. The shortcut avoids the requirement of the related party after the trader (essential requirement under the law), as well as it includes

¹⁰ Terms in cursive are accurate free translations of the sixth paragraph incorporated by Law 25,784 to Section 15 of the ITL.
deemed affiliation between the Argentine exporter and the trader who does not comply with the substance test. The regulation has been challenged on constitutional grounds.

b. Lessons learned by Argentine taxpayers, after eleven years of the “sixth method”

Lessons learned by Argentine taxpayers on the dynamics of the “sixth method” can be summarized in two different relevant periods, encompassing the last 15 fiscal years. They both share a common feature: since its enactment, the “sixth method” has been widely construed by tax authorities as a major revenue tool, and not as an exceptional, last-resource method for proper application of the arm’s length principle to determine prices in related-party transactions.

The latter approach created an unprecedented level of uncertainty, increased by its contradiction with Customs value provisions. Law 21,453—in force since 1976—fixes commodities prices at contract execution date for all Customs purposes, enforcing tax rates, taxable bases and valuation provisions in force at such date. The “sixth method”, as it provides for the alternative application of the shipment date for pricing purposes, brings about uncertainty, compromising value creation at origination. The suppression of uncertainty should be a goal for all transfer pricing regulations as it reduces unnecessary litigation which benefits all parties involved. This objective acquires significant importance in Argentina because any tax assessment on transfer pricing issues is usually followed by a criminal denounce.11 Furthermore, the regulations issued after the enactment of the sixth method revealed contradictions with Customs law, which actually converted the sixth method mainly in a punitive mechanism or a fine.12

A first period comprises the fiscal years previous to the enactment of the “sixth method”, introduced to the Income Tax Law by a 2003 reform. Tax authorities attempted its retroactive

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11 Argentina Criminal Law only requires an assessment of barely USD 45,000 to initiate a criminal proceeding.
12 The pricing date for sixth method purposes is the day of the end of the loading of the vessel, which only happens after the local exporter must file customs documents with a definitive price.
enforcement even in the absence of a supporting statutory provision. Pricing of related-party transactions at shipment date was sometimes grounded on allegedly benchmarking exercises, although devoid of any factual or legal support.

As far as public information is concerned, constitutional issues have also been raised in other controversies regarding the “sixth method”. In a case to be heard by the Federal Supreme Court in coming months, the taxpayer timely challenged the retroactive application of the “sixth method” to fiscal year 1999. In the corresponding Notice of Deficiency, tax authorities had allegedly cherry-picked the higher prices at shipment date for pricing adjustment purposes, thus de facto applying the “sixth method”.

Although the case was substantially entered for the taxpayer in the Federal Tax Court, the Court of Appeals reversed that decision later on, ratifying the tax assessment. On June 2014, the Prosecutor General issued a non-binding opinion on the case\textsuperscript{13}, in which she expressly highlighted that the Court of Appeals failed to analyze the taxpayer’s core argument that the notice of deficiency did imply a de facto application of the “sixth method”\textsuperscript{14}.

The issue has been also subject to debate by the Argentine courts in another landmark case. Although substantially entered for the tax authorities in 2014, the taxpayer had also alleged and evidenced retroactive application of the “sixth method”.

The second relevant period -which encompasses the fiscal years subsequent to the enactment of the “sixth method”- was characterized by the tax authorities’ unrestricted application of the novel method. Two different sub-stages can be distinguished in this respect, as tax authorities changed their grounds for applying the new methodology.

\textsuperscript{13} \url{http://www.mpf.gob.ar/dictamen/2014%5CMonti%5Cjunio%5CAlfred_Toepper_A_339_L_XLIX.pdf} (official Spanish version available as of January 2015).

\textsuperscript{14} Such outcome is the direct consequence of the way the Tax Authorities selectively picked up the transactions subject to tax assessment.
During the first years after the tax reform, Argentine tax authorities challenged related-party transactions not compatible with the arm’s length standard, based mainly on comparability analysis. The “sixth method” was hereby used for benchmarking purposes, reaffirming the accuracy of pricing related-party transactions at shipment date by comparison with uncontrolled operations. Complex comparability exercises were required, prompting the tax authorities to quit such approach.

Nowadays, availing of controversial terminology, tax authorities often incur in straightforward application of the “sixth method”, systematically challenging the substance of any international trader, thus converting this exceptional methodology into a general rule. The indiscriminate disqualification of triangular transactions, regardless of the role played by the intermediary, shall be construed as a cautionary tale, so as to avoid similar mistakes.

It shall not be overlooked that the presence of international traders in the supply chain after the Argentine sourcing is many times grounded on the need to outsource relevant value-adding functions, inherent to commodities international markets. Traders consolidate sources of supply so as to meet customer demand, efficiently addressing market concerns, such as seasonal asymmetries and supply chain instability. To this extent, they manage price volatility risks, undertaking major hedge functions and undertaking the associated risks. At the same time, they manage logistics, assuming the risks inherent to such function, and aiming at optimization of haulage and control costs. By freight swapping, significant savings on transportation can be made.

In addition, foreign exchange controls -for instance- could make it materially cumbersome to successfully hedge price volatility in the major international boards of trade, which many times require 24-hour material flows of funds just to honor a margin call. Prior Central Bank approval could make the latter simply non-workable. Additionally, Customs Law restrictions prevent exporters from fixing prices in a way different than a flat price, an issue that shall also be taken into account, as it hinders free pricing in the sector.
Therefore, the intervention of international traders, based in countries where commercial, financial and hedging functions can be performed without hindrance, becomes essential.

Unreasonable profit allocation to “unsubstantiated” intermediaries –i.e. not commensurate to its assets, functions and risks- could be efficiently challenged by a traditional transfer-pricing approach, focused on benchmarking with relevant independent-parties comparable transactions.

Unlike other commodities source markets, Argentine market conditions enable local taxpayers to avoid the need for adjusting international quoted prices so as to turn them into domestic CUP prices. As a matter of fact, the Ministry of Agriculture’s (SAGPyA) official reference FOB prices are widely recognized as representing valid Argentine CUP prices by taxpayers and tax authorities, a consensus uphold by case law. The existence of local CUP prices takes price levels out of the controversy, prompting discussions to turn to proper pricing date.

Another reason generally invoked so as to ground the application of the “sixth method” is the need to tackle alleged price manipulation by export companies, presumably achieved by artificially setting contract dates on the date commodities prices were the lowest. However, as the main elements of the export agreement shall be contemporaneously filed with the Ministry of Agriculture’s UCESCI for trade regulation purposes, exporters are prevented from speculating with pricing dates.

**Buenos Aires, February the 4th, 2015.**
## Annex II – CIARA and CEC associated members

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REPLY TO THE OECD’S REQUEST FOR COMMENTS ON THE “DISCUSSION DRAFT ON THE TRANSFER PRICING ASPECTS OF CROSS-BORDER COMMODITY TRANSACTIONS” FROM CMS

CMS is a European Economic Interest Grouping that coordinates an organisation of independent law firms:

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Do you authorize the OECD to publish your contribution on the OECD website? Yes
1. We would like to welcome the OECD initiative to consult companies and practitioners in
the framework of the specific guidelines issued regarding commodity transactions. We were
very interested in reviewing, in the light of Action 10 of the Action Plan on Base Erosion and
Profit Shifting, the “Discussion draft on the transfer pricing aspects of cross-border
commodity transactions” dated 16 December 2014 (further referred to as the “Discussion
Draft”).

2. We agree that the comparable uncontrolled price method (further referred to as the “CUP
Method”) can be an appropriate method for commodity transactions. Existence of quoted
prices in that framework is likely to make this method applicable more frequently than for
transactions in relation to other goods or services.

3. Furthermore, this method, when applicable, provides the taxpayers and the tax
administrations with a direct and reliable measure of the arm’s length price. In theory, the
CUP Method is the simplest to use. We therefore agree that it must be promoted every time
this method can be implemented in a relevant manner.

4. However, we would appreciate that the Discussion Draft emphasizes the conditions to be
fulfilled for choosing the CUP Method. The implementation of such method requires that the
comparability criteria as defined by the OECD Transfer Pricing Guidelines are fully met. That
is the reason why, in practice, taxpayers do not often use it. Existence of quoted prices is not
enough to state that they should necessarily represent a relevant approximation of an arm’s
length price.

5. The existence of public prices for certain goods could make the implementation of the CUP
Method possible for comparable properties. But other factors determining comparability, in
particular, functional analysis and contractual terms, must be fulfilled. For instance, quoted
prices relate to the direct purchase of the commodities. If an additional party, as a trader,
connects the seller and the buyer, price of the goods cannot be the same as for a direct
purchase by the buyer from the seller. In the same way, contractual terms must be taken into
account. A spot transaction is not comparable to a transaction for a delivery at a later date, for
a price agreed in advance. We therefore believe that the OECD should:

- Make a clear and explicit distinction, and discuss separately, transactions occurring
  on spot markets, from those occurring on futures markets, when it comes to
  observable market prices of commodities;
- Make it explicit that, except in (probably) very rare occasions, spot market prices
  should only be used if the intercompany transaction is a spot transaction, and that
  futures market prices should only be used if the intercompany transaction is
determined in advance (for future delivery);
• As the case might be, provide guidelines on the occasions which could cause exceptions to the rule above;
• More generally, better define, separately, which comparability criteria should be met for using, respectively, a sport market price reference, or a futures market price reference.

6. The same comment applies for the deemed pricing date for transactions mentioned in the Discussion Draft. The OECD proposes to use the date of shipment as a deemed date. In the context of commodity transactions, prices over the market may change rapidly so the date of the transaction is a key element to be taken into account during the analysis. We therefore have doubts about the date of shipment as being a deemed pricing date because in many situations it will not correspond to a true and fair view of an arm’s length transaction.

7. As a conclusion, the use of quoted prices as the basis for the determination of transfer prices corresponds to the CUP Method implemented with external comparables. We therefore think it would be appropriate that the OECD reminds that taking care of all comparability criteria, and not only characteristics of property or services, is decisive for the analysis.

8. We thank you for giving us the opportunity to share with you our comments and would be pleased to provide you with any additional detail you would be interested in.
Transfer pricing aspects of cross border commodity transactions – Concerns and Recommendations

A REPRESENTATION
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BEPS: Action 10 – Transfer pricing aspects of cross border commodity transactions – Concerns and Recommendations

Background

On December 16, 2014, the OECD issued a Discussion Draft on Transfer Pricing aspects of cross-border commodity transactions (Discussion Draft) for public consultation. The Discussion Draft has primarily been driven by the concerns of commodity-dependent developing countries regarding following actions that may lead to Base Erosion and profit shifting (BEPS) in cross border commodity transactions:

(i) The use of pricing date conventions which appear to enable the adoption by the taxpayer of the most advantageous quoted price;
(ii) Significant adjustments to the quoted price or the charging of significant fees to the taxpayer in the commodity producing country by other group companies in the supply chain (e.g. processing, transportation, distribution, marketing); and,
(iii) The involvement in the supply chain of entities with apparently limited functionality, which may be located in jurisdictions with nil or low taxation.

The Discussion Draft proposes the use of quoted commodity prices as a starting point for TP purposes, where the quoted prices are used in commercial transactions between third parties. The Discussion Draft also observes that contracts may provide for shipment at some point in the future, and commodity prices may fluctuate significantly in the intervening period and therefore proposes that the actual pricing date agreed between the parties should be used where there is reliable evidence supporting it. Where the evidence is not consistent with the agreed date, then tax authorities may assume a pricing date consistent with the facts. In the absence of reliable facts indicating the pricing date, tax authorities can assume it to be the date of shipment (supported by the bill of lading or similar document).

In general, we recognize the efforts of G20 along with the OECD towards providing guidance on transfer pricing on cross border commodity transactions. However, in view of the existing Indian tax system and the legal and economic environment in India, we foresee certain practical challenges in the implementation of the recommendations of the Discussion Draft in its present form for companies operating in India.

We wish to highlight some of the possible concerns and humbly put forth our recommendations for your kind consideration.
Situations where CUP may not be considered appropriate for transfer of commodities

Concerns

The discussion draft does not cover application of CUP method in specific situations/market characteristics such as where a single supplier or set of suppliers drive the market for the product (Monopoly/oligopoly scenario) or where the demand is more than the supply in specific locations (thereby resulting in demand getting in-elastic to the price). In such cases, the price is likely to be influenced by such market characteristics and the quoted price may not be appropriate reference point for determining arm’s length price for transactions between associated enterprises (AEs).

Other scenario may include transfer of intermediary products / by products by one group company to another group company. The transfer of intermediary/by products is generally not governed by the same consideration as that of final product and therefore, may require different pricing deliberations. Similarly, pricing for the commodities under long term sourcing contracts would be different from the spot pricing. In such cases, CUP may not be used as an appropriate method for commodity transactions between AEs.

Recommendations

It is recommended that the Discussion Draft may also cover such scenarios wherein CUP method may not be regarded as the most appropriate method for commodity transactions or provide guidance on the adjustments which may be required to be made to the prices for ensuring comparability.

Deemed Pricing Date

Concerns

The discussion draft proposes to adopt deemed pricing date as “shipment date” in the absence of reliable evidence of the actual transaction/pricing date between the associate enterprises (AEs). The discussion draft does not cover guidance on documentation/details/information that would be required to support pricing date or shipment date. In case of use of deemed pricing date, there is a possibility of significant variation between the actual transaction price and the price on shipment date which may result in Transfer Pricing adjustment in the hands of taxpayers. The taxpayers may be required to keep track of dual prices i.e. one for transaction date and the other for shipment date.
Recommendations

It is recommended that instead of deemed pricing date, OECD may provide guidance on the documentation/information that the taxpayers should maintain to provide reliable evidence of the actual pricing date agreed between the parties that can be considered by tax administrations in determining the appropriate pricing of the transactions.

Quoted price

Concerns

The draft provides that the CUP method can be an appropriate transfer pricing method for establishing the arm’s length price for the transfer between associated enterprises of commodities for which a quoted or public price is available. The draft further suggest that a quoted price also includes prices obtained from recognized and transparent price reporting or statistical agencies, or from governmental price-setting agencies, where such indexes are used by unrelated parties to determine prices in transactions between them. In several cases, the quoted prices may not be available for certain commodities / jurisdictions. In this absence of quoted prices, the reliance may also be placed on the prices cited in relevant industry/commercial publications. However, the discussion draft does not explicitly provide for use of such industry/commercial publications.

Recommendations

It is recommended that the term “quoted prices” should be defined to explicitly include the use of prices cited in relevant industry/commercial publications for determination of arm’s length price of goods transferred between group companies.

Considerations of hedging contracts

Concerns

The discussion draft presently does not provide any guidance regarding hedge cover that may have been taken by the group as a whole or by transacting entities. In case the AEs enter into transaction based on option or forward contracts, the price of transaction would be different from the quoted market price. In such cases, the tax authorities may resort to applying CUP and imposing transfer pricing adjustments in the hands of taxpayers without considering the terms and conditions of the hedging contracts.

Recommendations
The discussion draft may cover in detail the situations where the pricing may differ from the market price based on hedging contracts and the mechanism for tax administrations and tax payers to determine the transaction price taking into consideration the terms and conditions of the hedging contracts.

Comparability adjustments to quoted price

Concerns

The Discussion Draft recognizes that while determining the arm’s length price for commodities, some adjustments in quoted prices may be required for various differences between the terms and conditions of the actual transactions and quoted price such as on account of physical differences in the products, further processing cost, different specifications of a transaction, freight etc. The OECD in the present Discussion Draft has not provided any guidance for common adjustments for differentials but has requested information from public about the common adjustments to quoted price and the source of such information.

Recommendations

Comparability adjustments are important aspect for determination of arm’s length price under CUP method. Accordingly, it is recommended that the guidance to be included by OECD on this aspect is very clear and detailed (including examples) on the nature and circumstances as well as the mechanism for any such adjustment in order to avoid imposition of arbitrary approaches by tax authorities for determining comparable adjustments.
The Confederation of Indian Industry (CII) works to create and sustain an environment conducive to the development of India, partnering industry, Government, and civil society, through advisory and consultative processes.

CII is a non-government, not-for-profit, industry-led and industry-managed organization, playing a proactive role in India's development process. Founded in 1895, India's premier business association has over 7200 members, from the private as well as public sectors, including SMEs and MNCs, and an indirect membership of over 100,000 enterprises from around 242 national and regional sectoral industry bodies.

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With 64 offices, including 9 Centres of Excellence, in India, and 7 overseas offices in Australia, China, Egypt, France, Singapore, UK, and USA, as well as institutional partnerships with 312 counterpart organizations in 106 countries, CII serves as a reference point for Indian industry and the international business community.

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The Confederation of Swedish Enterprise is Sweden’s largest business federation representing 49 member organizations and 60,000 member companies in Sweden, equivalent to more than 90 per cent of the private sector.

The Confederation of Swedish Enterprise is pleased to provide comments on the OECD Discussion Draft entitled "BEPS Action 10: Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions" 16 December 2014 - 6 February 2015 (hereinafter referred to as the Draft).

The Confederation of Swedish Enterprise supports the work by OECD to ensure that transfer pricing outcomes are aligned with value creation. Developments of the OECD Transfer Pricing Guidelines (the Guidelines) in the area of commodity transaction are welcomed as it could give clarity and predictability to taxpayers and tax authorities and thereby reducing the risk of double taxation. Enhanced guidance in this regard will have a positive impact on the daily operations of MNEs involved in cross border commodity transactions and should be aimed at substituting locally implemented approaches in this area.

It is important that tax authorities understands the complexity related to commodity markets, including the different parties involved. Commodities can have very different characteristics and their markets can have significant differences as well. As a consequence the value chain in different MNEs dealing with commodities may vary significantly. In addition, MNEs are organized in different ways with different
production processes and so on. Therefore there is a need to further analyze flexible approaches that allows for all differences to be taken into consideration.

The use of quoted or publicly available prices, as a particular application of the Comparable Uncontrolled Price method, has been used for many years by MNEs when pricing commodity transactions with related parties. We support any initiative that would facilitate agreement and standardization of the sources of information that should be used for the application of this approach.

In relation to the deemed pricing date for commodity transactions, we believe that the terms adopted by the related parties should be the starting point. The Draft suggests that if the taxpayer can provide “reliable evidence” of the actual pricing date agreed between the associated parties, then tax administrations should take that date as reference. The Confederation of Swedish Enterprise requests additionally clarification as to the meaning of “reliable evidence”.

In agreement with BIAC we believe that where no reliable evidence is available of the terms adopted or where the date is inconsistent with other facts of the case, then tax administrations should have the burden of proof and should seek to gather the relevant facts in order to establish the pricing date that would be most appropriate from an arm’s length perspective. The deemed pricing date method should only be used as a last resort in cases where the tax payer has failed to provide any reliable evidence.

The differences between prices regulated through long-term contracts and prices agreed transaction by transaction should be acknowledged. Where the price is agreed on a transaction basis, the requirement to document each and every transaction for transfer pricing purposes is excessive. Therefore tax administrations should be ready to accept validation of prices at arm’s length through alternative approaches. Such an approach could be to use quoted prices supplemented with comparability adjustments, using sampling or selection of the most relevant transactions.

On behalf of the Confederation of Swedish Enterprise

February 6, 2015

Krister Andersson
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delivered by email: transferpricing@oecd.org

6 February 2015
Ref: FC/JB/EF

Dear Mr Hickman

Response to Public Discussion Draft
Base Erosion and Profit Shifting (BEPS) Action 10: Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions

Thank you for the opportunity to present our submission in response to the “BEPS Action 10: Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions” (the Discussion Draft), included as Appendix A, please find below our comments on the Discussion Draft and specifically three points raised therein:

1. Specific reference to the use of the Comparable Uncontrolled Price (CUP) method
2. Adoption of deemed pricing dates

Inclusion under Action 10

Prior to considering the three focus areas set out in the Discussion Draft, we refer to comments made regarding the release of this paper under Action 10 of the BEPS Action Plan. As stated in the introductory section of the Discussion Draft, Action 10 focuses on BEPS resulting from “transactions which would not, or would only very rarely, occur between third parties”.

Commodity transactions between third parties are widespread in global markets. Indeed, the very reference to quoted pricing and available databases is evidence of the extensive network of third parties undertaking the purchase and sale of commodities and, the existence of numerous, large, trading entities which purchase and sell minerals, oil, gas and other commodities with third parties (and also in some cases with related parties) is a notable feature of the market.

Notwithstanding our comments regarding the frequency of commodity transactions, we support the work commenced by the OECD to review and provide further transfer pricing guidance on what are commonly highly complex and nuanced transactions that occur in dynamic and continually evolving global markets. Given the complexities, some of which we illustrate in our submission below, we caution against a rushed and/or overly simplified response and recommend that further review work be completed by the OECD before any recommendations are finalised. We would be pleased to take up the offer to continue providing input into the review work being undertaken.

Breadth of application

While many of our comments could be applied generally to all commodities, our specific reference points and examples have been limited to mineral commodities and oil and gas, being the primary areas of our experience and expertise. In addition, our comments also include references to ‘intermediary products’, i.e. those which do not have a specifically

1 Page 1 of the Discussion Draft
listed/quoted price but which are bought and sold on the general market, often with pricing referenced to an associated product, for example, the sale of gas referenced to oil pricing. It is our view that these products, along with relevant by-products, should also be specifically referenced to be covered by any guidance. Further, we have made no distinction between commodities with different end purposes, for example an end mineral such as gold, compared to a fuel such as coal or LNG.

Specific reference is given in Paragraph 2 of the Discussion Draft to “the sale and purchase of commodities” as the definition of ‘commodity transactions’. We would suggest consideration of this definition being broadened to “arrangements relating to the sale and purchase of commodities” thereby also including transactions involving agency representatives and trading house arrangements which are extremely common in the industry.

In Paragraph 3 of the Discussion Draft, reference is made to “providing a consistent set of rules”. We recommend clarification of this wording to confirm that the purpose of the Discussion Draft, and the Transfer Pricing Guidelines, is to provide guidance to taxpayers and tax authorities in determining transfer prices, rather than to set out prescriptive rules. We do agree that, with better understanding of these transactions and the markets within which they occur, the provision of additional guidance would remove the need for country specific methodologies which make the global application of transfer pricing more difficult. However, if the final version of this document is to be an exhaustive set of rules, we would recommend that significantly more information relating to all aspects of commodity transactions be included.

Use of the CUP method

In considering the use of the CUP method, we agree with the comments in the Discussion Draft that the CUP will generally be the most appropriate method to apply when looking at the pricing of commodities. We further appreciate, and agree with, the OECD views that the use of quoted (or listed) prices should be allowed as a potential CUP. The acceptance of such prices is consistent with the types of information available and referenced by the industry.

We note however, that in applying the CUP method, to the extent comparability adjustments are required to be made, the method selection could shift to that of the Resale Price (RP) method, for the sole purpose of allowing for relevant comparability adjustments, for example, value adding downstream activities. However the starting point, of the application of the RP method would remain a CUP. We include this commentary to ensure there is clarity available for both taxpayers and tax authorities, when faced with the complexities of applying the CUP method in practice.

We also note that, for sales of intermediary products (e.g. feed gas, rare earths concentrate and magnetite ore) between different parts of a vertically integrated supply chain, the profit split method may be the most appropriate and reliable method.

In respect of the use of the term “quoted prices”, to avoid confusion both for taxpayers and tax authorities on the types of quotes which may be acceptable, we recommend consideration of a specific definition to be included to differentiate a quoted or listed price from a proposed price, for example an unsigned sale contract, being available as a potential CUP.

We also suggest that when referencing the specific sources of the quoted pricing, as included in Paragraph 9 of the Discussion Draft, that an additional comment is included to state that other available CUP sources may be used as relevant for the specific commodity. For example, the use of Japanese Cleared Customs (JCC) crude in relation to Asian LNG transactions or the GlobalCoal reference points in respect of thermal coal.

In addition to the use of listed/quoted prices in applying the CUP method, some companies have access to internal transactions which could also be considered as potential comparable arrangements. Indeed, in many instances these dealings may be for the identical product and therefore provide a better comparable than external CUP information. No comment is made in the Discussion Draft to either include or exclude the use of potentially available internal comparable transactions which could, by the omission, cause confusion as to the acceptability of such CUPs. Therefore we recommend a specific reference is made to internal comparable transactions being allowable, provided they meet the same comparability requirements as the external CUPs.

2 The downstream is used as an industry reference for activities which are completed after extraction (which is the upstream). The downstream could include, but is not limited to, processing, sales and marketing, shipping and logistics.

3 Internal comparable transactions should be distinguished from secret comparable transactions. We are referring to internally available information which would be made available to the relevant tax authorities as part of any review or transfer pricing documentation project.
An important point within the Discussion Draft, at Paragraph 10, is the recognition that when applying the CUP method it is appropriate to adjust the CUP to improve the reliability of the analysis. Due to limitations on the amount of ‘perfect’ comparable information available for individual commodities, this recognition of undertaking adjustments rather than rejecting a potential CUP will go a long way to assist taxpayers in reliably supporting their arrangements.

In respect of comparability, identification of the appropriate source of CUP information for commodity transactions should be considered in the first instance. For example, many of the list prices available are the price paid by the end customer for a specific product. If reliable adjustment cannot be made, this may not be the most appropriate source of information. In some cases CUP information from a particular source may not be appropriate or may require adjustment for a function which is undertaken after the sale point between related parties. One example of this is where a potential CUP is available relating to domestic LNG sale arrangements; however CUP data is needed for international LNG sales, meaning an adjustments or alternate source may be required. Or, where the company offers a blended product for sale, e.g. coal, and the CUP relates to the blended product. It may be necessary to disaggregate the components of the blended product to allow for each party to receive the appropriate remuneration for its contribution, including the location undertaking the blending. Similarly, in some instances processing may be completed at different sites. For example, copper mining, concentrate production, copper refining and copper smelting may all be undertaken at different locations in the supply chain. This can mean that only certain available CUPs may be relevant or adjustments required. In these instances internal comparable information may prove easier to apply. All of these examples should be covered through the application of the comparability factors as part of the transfer pricing analysis.

Reference is made within the Discussion Draft that the pricing of commodities should reflect where the value is created and should remunerate value adding functions. Our comments on potential comparability adjustments have been included in our response as part of the third question raised in the Discussion Draft which specifically relates to this issue.

The recognition by the OECD that value can be added by a number of functions within a supply chain prior to sale shows consideration by the authors of the complex supply chains required to extract, process and sell commodities. However we note that sales and marketing is not specifically mentioned in the Discussion Draft despite it being a common area of contention between multinational taxpayers and tax authorities when considering commodity transactions.

Similar to other functions within often complex supply chains, sales and marketing is a valuable function which often doesn’t just find customers for the product in question, but rather optimises the revenue to the entire group and often manages large amounts of risk relating to the sales process. An example of this would be the decision making process entered into by a marketing team in respect of product mix and optimising product mix. Based on a marketers’ in-depth knowledge of customers, their needs and their willingness to pay for certain products, the marketers would often be able to make decisions about the level of processing or blending that should be done to the raw product to optimise the total revenue received. For example, whether a barrel of oil is processed to produce a lower volume of high octane fuel or whether the revenue would be optimised with a higher volume, lower priced fuel; or, in the case of coal, how blending of different specifications should be undertaken to ensure that no penalties regarding contract specification are incurred, but also higher grade coal is not wasted where a premium cannot be charged (e.g. blending extremely high grade metallurgical coal with thermal coal to bring it within the contract specification, thereby selling thermal coal at a metallurgical price). A marketing team may also be responsible for finding alternative customers and maximising the sale price of shipments in transit if a contract is cancelled or other customer performance risks materialise, for example a number of customers electing to take minimum allowable cargoes. This can often happen when market prices begin to drop. In this scenario a marketing team would often mobilise quickly to resell any volumes to minimise the loss of revenue to the entire group.

It is recognised that for certain products, e.g. those listed on the London Metal Exchange (LME), there may be a view that marketing adds less value as commodities could simply be sold to an LME warehouse. For an individual shipment, we agree that this might be the case. However, the responsibility of a marketing team involved in such transactions if commonly to ensure that the entire group, including the extraction company receives the best price for its product on a consistent basis, which could be higher than the LME price, due to factors which are not included in a simple product specification price calculation, for example relationships or branding.
The Discussion Draft specifically references consideration of the level of the market at which the transactions have taken place at Paragraph 12, point 3. In light of the comments above, we suggest that when examples are provided which reference processing, that sales/marketing also be included.

While it may be implied within the current Discussion Draft, we would suggest specific reference is made upfront that all comparability factors must be considered and applied when selecting and adjusting comparable information, and that the points specifically mentioned are examples only, rather than an exhaustive list. Further, in considering the value adding functions, we suggest that sales and marketing should be specifically referenced.

Deemed pricing dates

As stated in the Discussion Draft, the pricing of commodities can move significantly in a short amount of time. The recent movement in oil prices has been evidence of this. As such, the date, or period, (generally referred to as a quotational period or QP) on which the sale price is based, can have a significant impact on the total value of a particular transaction. Therefore, we can understand the OECD’s specific focus on this particular issue.

Further, when considering the limitations on available information for developing countries, described in the Discussion Draft at Paragraph 7, guidance on a benchmark deemed pricing date may be helpful in some instances.

As an initial point, we agree that where a QP is not specifically defined in an agreement between the parties, that the bill of lading date is an appropriate proxy to be used. However, we suggest that the proposed new wording make it clear that the deemed pricing date is not the only acceptable quotational period and is only to be used in extenuating circumstances. Further, this deemed pricing date should not be considered a safe harbour by taxpayers or tax authorities to remove the need for in-depth review and documentation of the issue.

In addition, to the extent that a company can provide legal agreements that set out the agreed pricing date between the related parties and transfer pricing documentation to support the arm’s length nature of the arrangement including the QP applied, we suggest it is made clear that the facts of the case cannot be overridden arbitrarily. While this is stated at the beginning of the proposed paragraph to be included in the Transfer Pricing Guidelines, the following sentence refers to “the pricing date...is inconsistent with other facts of the case”, which changes the assessment into a subjective review of the overall arrangement rather than a question of fact regarding documentation of a clear pricing date convention. We recommend this wording be replaced with wording that relates solely to the pricing date selected and the available documentation and support.

The Discussion Draft makes specific reference, in Paragraph 13, to applying different options for QPs that can be built into the contracts and priced at the outset. We note that in commercial dealings between third parties QPs vary considerably and could vary at the option of the buyer, the seller, or both. Further guidance from the OECD in respect of the arrangements contemplated, including the OECD’s view on the related transfer pricing implications would be welcomed.

It is our view that the arbitrary application of a deemed pricing date, could result in double taxation for companies entering into sale and purchase transactions with related parties with pricing dates that differ from the deemed pricing date, if a tax authority on one side of a transaction overrides the transaction pricing terms with the deemed pricing date as a safe harbour.

As a final point, we suggest that wording be included to clarify that any guidance relating to deemed pricing dates relates only to the date of the pricing and has no impact on the other terms of the arrangement, for example shipping, insurance or credit terms.

Comparability adjustments

Based on our experience, there are three broad categories of comparability adjustments that are commonly made in respect of pricing commodities:

1. commodity adjustments - which relate to the actual product being purchased/sold
2. functional adjustments – which relate to the functional profiles (i.e. functions, assets, risks) of the two transacting parties
3. contractual adjustments – which relate to the specific terms agreed in the sales contracts.

* See Paragraph 15 on page 7 of the Discussion Draft
We have included below some examples of the different types of adjustments we have observed in working in this area. The examples provided do not represent an exhaustive list, but are included to provide guidance to those developing a bank of knowledge in this area or where there is a lack of current available information.

**Commodity adjustments**

Adjustments are common when using a reference price to reflect differences in the specifications of the actual product being sold. This is because many reference prices, or internal comparables, relate to a specific type and/or quality of product. For example, aluminium is listed on the LME and many contracts reference the LME price as the starting point for the calculation of the sale price under the contract. Adjustments are then agreed between the contracting parties to reflect any variations from the LME specifications, or alternatively to reflect source country premiums.

GlobalCoal releases a number of thermal coal reference price lists for different ports around the world. By way of example, the list for Australia relates to the Port in Newcastle, New South Wales, referred to as NEWC. This reference price relates to a thermal coal, not coking or pulverised coal injection, with specific energy, ash, sulphur and moisture contents. Similarly, the Platts index sometimes used for iron ore pricing is based on a specific list of characteristics, including iron (Fe) content, cargo size, moisture and various impurities. Adjustments are then made to include premiums and discounts to reflect difference in the products being sold. It should be noted that the existence of a difference in specification on the product actually delivered, for example increased energy for coal, does not automatically result in a movement in the price. The price is struck on the contracted product. To the extent the supplier delivers a ‘better’ product, there may or may not be an adjustment in the price, depending on the agreement between the parties.

The export sale of LNG is often referenced to an oil price, for example Brent or JCC. The pricing commonly refers to a percentage of the oil price plus a fixed component and is set out in three steps, an S Curve, to allow for a cap and floor on the pricing. Historically there may have been a link between the fixed component and a return of capital, and the percentage of the oil price to the energy content of the LNG when compared to a barrel of oil. However, with the dramatic increase in global trading of LNG, pricing for sales for example in the Asia Pacific region has begun to shift away from this norm towards a negotiated price outcome, meaning that S Curve pricing should be looked at as a whole when trying to make comparisons.

It is also important to note that adjustments for differences in the characteristics of commodities are not always linear, as the value-in-use of a particular set of attributes if often taken into account from the purchaser’s perspective. For example, the difference in the iron ore price per ton between ore with a 60% Fe content and ore with 58% Fe content may be significantly higher than the difference between ore at 56% and 54% Fe, depending on the requirements of the specific steel mill that is using the iron ore in its smelting process.

The reliability of the data sources used for making adjustments should also be considered. For certain commodities, e.g. crude oil, there is a depth of index data available that can be used to calculate the impact of differences in particular characteristics on the product pricing. For example, regression analysis can be used to establish an arm’s length price for a particular type of crude oil based on its characteristics as compared to a number of different indices. For other commodities, only limited benchmarks are available and therefore other sources of data may be required to make reliable adjustments. In these cases, guidance on practical approaches that could be adopted and accepted by tax authorities in making adjustments for transfer pricing purposes would be welcomed.

**Functional adjustments**

Functional adjustments are undertaken to reflect differences in the functions, assets and risks of related parties under contracts when compared to the arrangements covered by the quoted prices. The types of adjustments we generally encounter include, but are not limited to:

- processing or blending, for example, the product sold may require some form of processing or blending to reach the specifications of the benchmark product, or prior to resale to a customer
- level in the market, for example, quoted prices are often the sale to the end customer and therefore include all the functions from extraction to sales and marketing and delivery, however the related party sale may be made to a centralised sales and marketing or trading entity thereby requiring the price to be adjusted to reflect this
- stockpiling and consolidating / splitting cargoes to meet customer demands
credit risk, for example, one party may assign credit risk on end customer collection which requires an adjustment to the price

shipping/location, for example, the benchmark price may include shipping costs between two points and adjustments may be required to reflect different shipping distances in the controlled dealing.

It is our understanding that additional research is being completed in relation to common adjustments made to commodity prices to assist developing countries in reviewing and testing transfer pricing for commodities. We would welcome the opportunity to comment further following the release of the findings, including providing input on how the information may be used to ensure consistency with the arm’s length principle and avoid potential unnecessary inappropriate use by tax authorities by way of safe harbours.

**Contractual adjustments**

Contractual terms could also be considered a subset of functional adjustments, but relate specifically to the terms of the contract and the functions, assets and risks that attach to these terms. These might include:

- Inco terms of the contract, for example, as many coal and iron ore contracts are on an FOB basis or LNG on a DES basis, adjustment will be required to take into account the different costs and risks which are transferred as a result of these terms
- payment terms, for example, one party may extend longer than normal credit or financing terms which should also be taken into account
- pricing limits, for example, caps and floors in the movement of prices over a period of time
- payment methods, for example, the use of letters of credit
- force majeure
- the quantity of product purchased, i.e. volume adjustments
- the number of shipments agreed to, for example, single or multiple transactions, take-or-pay arrangements or flexibility in agreed cargoes
- term of the agreement, for example, if the sale contract is a spot contract, short term contract (i.e. less than 12 months), midterm contract (3 to 5 years) or long term contract (5 years to life of project).

Each of these terms can have an impact on the end price or the drivers of the negotiation between the parties.

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In concluding, we reiterate our caution against overly simplified discussion and guidance on the transfer pricing issues arising from what are often complex commodity transactions and recommend that further review work be completed by the OECD before any recommendations are finalised. Of course, we appreciate the opportunity to comment on the Discussion Draft and would welcome further opportunities as the OECD’s work is advanced.

Yours sincerely

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Director
Deloitte Tax Services Pty Ltd
Appendix A

BEPS Action 10: Discussion Draft on the Transfer Pricing Aspects of Cross Border Commodity Transactions
Public Discussion Draft

BEPS ACTION 10: DISCUSSION
DRAFT ON THE TRANSFER PRICING
ASPECTS OF CROSS-BORDER
COMMODITY TRANSACTIONS

16 December 2014 - 6 February 2015
Public comments are invited on this discussion draft which deals with work in relation to Action 10 (“Assure that transfer pricing outcomes are in line with value creation” in the context of “other high-risk transactions”) of the BEPS Action Plan.

The Action Plan on Base Erosion and Profit Shifting, published in July 2013, identifies 15 actions to address BEPS in a comprehensive manner, and sets deadlines to implement these actions.

Action 10 of the BEPS Action Plan, identifies that work needs to be undertaken to develop “rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to … (iii) provide protection against common types of base eroding payments.”

Within this mandate, Working Party No. 6 on the Taxation of Multinational Enterprises has considered transfer pricing issues in relation to commodity transactions that may lead to base erosion and profit shifting. Problems reported by some countries involve difficulties in determining adjustments made to quoted prices, verifying the pricing date, and accounting for the involvement of other parties in the supply chain. The issues may be most acute for commodity dependent developing countries, for which the commodity sector provides the major source of economic activity, contributing in a significant manner to employment, government revenues, income growth and foreign exchange earnings. In this discussion draft, the term “commodities” refers to physical products for which a quoted price is used by independent parties to set prices.

In response to these issues, some countries have adopted specific unilateral approaches for pricing commodity transactions, such as the so-called sixth method in the Latin American region. The emergence of such approaches has highlighted the need for clearer guidance on the application of transfer pricing rules to commodity transactions. To this aim the following proposals have been developed under the BEPS Project, on which comments are sought:

A. Additional guidance in Chapter II of the Transfer Pricing Guidelines clarifying that: (i) the comparable uncontrolled price method can be an appropriate transfer pricing method for commodity transactions between associated enterprises; and, (ii) that quoted or publicly available prices (“quoted price”) can be used under the CUP method as a reference to determine the arm’s length price for the controlled commodity transaction.

B. Additional guidance in Chapter II of the Transfer Pricing Guidelines regarding the adoption of a deemed pricing date for commodity transactions between associated enterprises in the absence of evidence of the actual pricing date agreed by the parties to the transactions.
C. Potential additional guidance on comparability adjustments.

The proposed guidance seeks to ensure that pricing reflects value creation, thereby protecting the tax base of commodity dependent countries, by ensuring that parties performing value-adding functions in relation to the commodity being transferred are remunerated with arm’s length compensation.

Transfer pricing work being undertaken under BEPS Action 9 (on risk and capital), BEPS Action 10 (especially on recharacterisation and low value-adding services) and BEPS Action 13 (transfer pricing documentation and country-by-country reporting) is also relevant to commodity transactions and will help to ensure that transfer pricing outcomes in commodity transaction are in line with value creation.

The views and proposals included in this discussion draft do not represent the consensus views of the CFA or its subsidiary bodies but are intended to provide stakeholders with substantive proposals for analysis and comment.

This discussion draft is submitted for comment by interested parties. Comments should be submitted by 6 February 2015 (no extension will be granted) and should be sent by email to TransferPricing@oecd.org in Word format (in order to facilitate their distribution to government officials). They should be addressed to Andrew Hickman, Head of Transfer Pricing Unit, Centre for Tax Policy and Administration. It is requested that comments be provided in separate text containing references to paragraph numbers of the Discussion Draft, instead of in the form of a mark-up of the text of the Discussion Draft itself.

Please note that all comments received regarding this consultation draft will be made publicly available. Comments submitted in the name of a collective “grouping” or “coalition”, or by any person submitting comments on behalf of another person or group of persons should identify all enterprises or individuals who are members of that collective grouping or coalition, or the person(s) on whose behalf the commentator(s) are acting.

A public consultation on the discussion draft and other topics will be held on 19-20 March 2015 at the OECD Conference Centre in Paris. Registration details for the public consultation will be published on the OECD website in due time. Speakers and other participants at the public consultation will be selected from among those providing timely written comments on the discussion draft.
DISCUSSION DRAFT ON THE TRANSFER PRICING ASPECTS OF CROSS-BORDER
COMMODITY TRANSACTIONS

I. Introduction

1. The commodity sector provides the major source of economic activity for many countries, especially developing countries, in which the commodity sector contributes significantly to employment, government revenues, income growth and foreign exchange earnings. Accordingly, for many of these countries, dependence on commodities has defined their economic policy (making commodity exports the primary driver of growth and investment) and development trajectory.

2. There are several problems and policy challenges in respect of commodity transactions faced by tax administrations generally and, most acutely, by tax administrations of commodity-dependent developing countries. One of these main issues is transfer pricing-oriented tax base erosion resulting from cross-border controlled transactions the object of which is the sale or purchase of commodities (“commodity transactions”). Countries have reported the following key transfer pricing issues that may lead to base erosion and profit shifting (“BEPS”) in cross-border commodity transactions:

   • The use of pricing date conventions which appear to enable the adoption by the taxpayer of the most advantageous quoted price;

   • Significant adjustments to the quoted price or the charging of significant fees to the taxpayer in the commodity producing country by other group companies in the supply chain (e.g. processing, transportation, distribution, marketing); and,

   • The involvement in the supply chain of entities with apparently limited functionality, which may be located in tax opaque jurisdictions with nil or low taxation.

3. In response to these issues some countries have adopted specific domestic approaches for pricing commodity transactions. An example would be the so-called sixth method adopted by a number of countries in Latin America. The emergence of such approaches has highlighted the need for clearer guidance on the application of transfer pricing rules to commodity transactions. The proposals described below aim at providing a consistent set of rules within the arm’s length principle to determine the arm’s length price for commodity transactions, which not only reduces the opportunities for BEPS, but also minimizes the instances where double taxation may occur.

4. The following proposals are covered in this discussion draft:

   1. Additional guidance in Chapter II of the Transfer Pricing Guidelines clarifying that: (i) the comparable uncontrolled price method can be an appropriate transfer pricing method for commodity transactions between associated enterprises; and, (ii) that quoted or publicly available prices (“quoted price”) can be used under the CUP method as a reference to determine the arm’s length price for the controlled commodity transaction.
2. Additional guidance in Chapter II of the Transfer Pricing Guidelines regarding the adoption of a deemed pricing date for commodity transactions between associated enterprises in the absence of evidence of the actual pricing date agreed by the parties to the transactions.

3. Potential additional guidance on comparability adjustments.

5. Transfer pricing work being undertaken under BEPS Action 9 (on risk and capital), BEPS Action 10 (especially on recharacterisation and low value-adding services) and BEPS Action 13 (transfer pricing documentation and country-by-country reporting) is also relevant to commodity transactions and will help to ensure that transfer pricing outcomes in commodity transaction are in line with value creation.

6. The proposals aim to create greater consistency in the way tax administrations and taxpayers determine the pricing of commodities under the arm’s length principle. The proposals take into account concerns expressed by some tax administrations about the difficulty they face in obtaining information to verify the price of commodities, including pricing date conventions and comparability adjustments. The proposed guidance seeks to ensure that pricing reflects value creation, thereby protecting the tax base of commodity dependent countries by ensuring that parties performing value-adding functions in relation to the commodity being transferred are remunerated with arm’s length compensation.

7. Implementation of any of these measures demands that tax administrations have knowledge of how the commodity markets operate and how commodity businesses contribute to value at various stages in the value chain. The development and implementation of transfer pricing rules which do not take into account the economic context, industry and business model in which associated enterprises operate and transact with one another may lead to arbitrary and unrealistic results and with that may lead to double taxation or double non-taxation hindering cross-border trade and investment. In their Communiqué of September 2014 G20 Finance Ministers and Central Bank Governors, under “Issues for Further Action”, have asked the OECD and the World Bank Group to explore ways to support ongoing efforts to improve the availability of quality transfer pricing comparability data for developing economies. In this context, research will be undertaken as part of the Tax and Development Programme to identify common adjustments to quoted prices to account for physical and functional differences in the controlled transaction and with that supplement the BEPS work with practical tools to help developing economies make maximum use of quoted prices for commodities. The research will focus on mineral commodities when they are traded as ores or in intermediate forms, initially covering iron ore, copper and gold.

II. Proposed additions to Chapter II of the Transfer Pricing Guidelines

A) The use of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method

8. The first proposal involves clarifying the guidance in the existing Transfer Pricing Guidelines stating that the CUP method would generally be the most appropriate transfer pricing method for commodity transactions and that, under the CUP method, the arm’s length price for the controlled commodity transaction can be determined, not only by reference to comparable uncontrolled transactions, but also by reference to a quoted price.

9. This proposal is grounded on the fact that for transactions involving the sale or purchase of commodities with a quoted price, such quoted price will generally provide evidence (taking into account any comparability adjustments needed) of whether or not the price agreed in the controlled transaction is arm’s length. Quoted prices are not set by a single individual or entity (except in the case of governmental price control), as they are the result of the interaction of supply and demand in the market for a certain quantity of a type of product at a specific point in time. Quoted prices for
commodities can be obtained from the transparent markets trading in commodities (e.g. London Metal Exchange, Chicago Board of Trade, Tokyo Grain Exchange) or from price reporting agencies (e.g. Platts, Argus or Bloomberg). In addition, there is considerable evidence that quoted prices are used as benchmarks or markers to price commodities in transactions between unrelated parties.

10. Where a quoted price is available for a commodity, and the terms and conditions of that comparable uncontrolled transaction are comparable to those of the controlled transaction, the quoted price may provide a reliable CUP. Where there are differences that have a material effect between the terms and conditions of the controlled transaction and the uncontrolled transaction represented by the quoted price, adjustments should be made to improve the reliability of the analysis. For this purpose, taxpayers and tax administrations could take as a reference the standard specifications, on which the price of the commodity is based, used in commodity markets and by price setting agencies.

11. The current Transfer Pricing Guidelines already indicate that the CUP method is an appropriate transfer pricing method to determine the price for commodity transactions. Indeed, paragraph 1.9 of the Transfer Pricing Guidelines acknowledges that the arm’s length principle has been found to work effectively in many cases involving the purchase and sale of commodities where an arm’s length price may readily be found in a comparable transaction undertaken by independent enterprises under comparable circumstances. Furthermore, the guidance in Chapter II on the CUP method is illustrated by an example where the CUP method is applied to determine the price for the sale of coffee beans (see paragraph 2.18), where the controlled and uncontrolled transactions are comparable (e.g. product features, trading and delivery terms) and occur in comparable circumstances (e.g. same stage in the production/distribution chain).

12. The following guidance is proposed to be inserted after existing paragraph 2.16 in Section B in Chapter II of the Transfer Pricing Guidelines:

1. The CUP method can be an appropriate transfer pricing method for establishing the arm’s length price for the transfer between associated enterprises of commodities for which a quoted or public price is available (“quoted price”), subject to the conditions of the controlled transaction and the conditions of the quoted prices being comparable. The reference to “commodities” shall be understood to encompass physical products for which a quoted price is used by independent parties in the industry to set prices in uncontrolled transactions.

2. Under the CUP method, the arm’s length price for commodity transactions may be determined by reference to comparable uncontrolled transactions and by reference to comparable uncontrolled arrangements represented by the quoted price of the commodity in the relevant period obtained in an international or domestic commodity exchange market. In this context, a quoted price also includes prices obtained from recognized and transparent price reporting or statistical agencies, or from governmental price-setting agencies, where such indexes are used by unrelated parties to determine prices in transactions between them. Quoted commodity prices generally reflect the agreement between independent buyers and sellers in the market on the price for a specific type and amount of commodity, traded under specific conditions at a certain point in time. A relevant factor in determining the appropriateness of using the quoted price for a specific commodity is the extent to which the quoted price is widely and routinely used in the ordinary course of business in the industry to negotiate prices for uncontrolled transactions comparable to the controlled transaction.

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1 These agencies assess prices for physical commodities. Usually, they do not participate, directly or indirectly, in the traditional financial markets. They generate their own proprietary price assessment by using transactional data and publicly available data such as future settlements in conformance with their published methodologies.
Accordingly, depending on the facts and circumstances of each case, quoted prices can be considered as a reference for pricing commodity transactions between associated enterprises.

3. For the CUP method to be reliably applied to commodity transactions, the commodity being transferred in the controlled transaction and the commodity in the uncontrolled transactions or in the comparable uncontrolled arrangements represented by the quoted price need to be similar, in terms of the physical features and quality of the commodity. In addition, the contractual terms of the controlled transaction should also be considered, such as volumes traded and the timing and terms of delivery. If the quoted price is used as a reference for determining the arm’s length price, the standardised contracts which stipulate specifications on the basis of which commodities are traded in the market and which result in a quoted price for the commodity may be relevant. Where there are differences between the conditions of the controlled transaction and the conditions determining the quoted price for the commodity that materially affect the price of the commodity transactions being examined, reasonably accurate adjustments should be made to ensure that the economically relevant characteristics of the transactions are sufficiently similar. Such differences can be related, for instance, to different specificities of the commodity (e.g. premiums for quality or availability of the commodity), different processing functions performed or required, or additional costs incurred for transportation, insurance or foreign currency terms. Consideration should also be paid to how unrelated parties use the quoted price as a reference price and make adjustments to reflect the position in the supply chain of the parties to the transaction.

4. In order to assist tax authorities in conducting an informed examination of the taxpayer’s transfer pricing practices, associated enterprises should document in writing, and include as part of their transfer pricing documentation, the price-setting policy for commodity transactions as well as any other relevant information related to the pricing of the commodity (e.g. pricing formulas used).”

B) Deemed pricing date for commodity transactions

13. Many transactions involving commodities involve physical delivery at a future date, although there can be circumstances when commodities are sold for immediate delivery (and may attract a premium over the quoted price). As a result there can be a significant period of time between entering into the contract and taking delivery of the goods. In that time, the quoted price of the commodity can fluctuate. There is considerable evidence that commodity transactions generally tend to be priced by reference to the quoted price within a quotation time period close to the time of shipment. However, options for fixing the price at different periods can be built into the contract (and priced at the outset), depending on the circumstances and risk appetite of the parties.

14. One of the challenges faced by tax administrations is the ability to verify the pricing date. To this aim, the following guidance proposes to introduce a “deemed pricing date” for commodity transactions in the absence of reliable evidence of the pricing date actually agreed by the associated enterprises in the controlled commodity transaction. The term “pricing date” refers to the specific date or time period selected (e.g. a specified range of dates over which an average price is determined) by the parties to determine the price for the commodity transactions. The proposed guidance deems the pricing date to be the quoted price, incorporating any comparability adjustments, on the shipment date as evidenced by the bill of lading or equivalent documents.

15. The following guidance is proposed to be inserted in Section B in Chapter II of the Transfer Pricing Guidelines, following the suggested text in paragraph 12 of this Discussion Draft:
5. “A particularly relevant factor for commodity transactions determined by reference to the quoted price is the pricing date, which refers to the specific date or time period (e.g. a specified range of dates over which an average price is determined) selected by the parties to determine the price for the commodity transactions. Where the taxpayer can provide reliable evidence of the actual pricing date agreed by the associated enterprises in the controlled commodity transaction, tax administrations should take the actual pricing date as a reference to determine the price for the commodity transaction. If the pricing date actually agreed by the associated enterprises is inconsistent with other facts of the case, the tax administrations may impute an actual pricing date consistent with the evidence provided by those other facts of the case (taking into consideration industry practices). In the absence of reliable evidence of the actual pricing date agreed by the associated enterprises, tax administrations may deem the pricing date for the commodity transaction to be the date of shipment as evidenced by the bill of lading or equivalent document depending on the means of transport. This would mean that the price for the commodities being transacted would be determined by reference to the quoted price on the shipment date, subject to any appropriate comparability adjustments. Furthermore, it is essential to permit resolution of cases of double taxation arising from application of the deemed pricing date through the mutual agreement process.”

C) Potential additional guidance on comparability adjustments to the quoted price

16. Where pricing of commodities is based on adjustments or differentials from a quoted price, it is understood that those adjustments or differentials may take into account physical differences in the product, different specifications required, freight, any further processing costs, and other features of the particular transaction. In some cases these adjustments or differentials are themselves based on information and costings which are transparent or standard in the industry.

17. Where pricing formulas rely on transparent or industry standard information, it would be helpful for tax administrations to be aware of such information when considering comparability adjustments. Respondents are, therefore, invited to provide information about the common adjustments or differentials applied to the quoted price and the sources of information used to determine such adjustments or differentials, and to indicate their interest in further consultation on issues related to this proposal.
Appendix B
Details of Contributors
<table>
<thead>
<tr>
<th>Name</th>
<th>Position – Transfer Pricing</th>
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<th>Email</th>
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</thead>
<tbody>
<tr>
<td>Fiona Craig</td>
<td>Partner</td>
<td>Sydney</td>
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<tr>
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<td>Partner</td>
<td>Perth</td>
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<tr>
<td>John Bland</td>
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<td>Ockie Olivier</td>
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<td>Emily Falcke</td>
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<td>Brisbane</td>
<td><a href="mailto:efalcke@deloitte.com.au">efalcke@deloitte.com.au</a></td>
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Comments on the Public Discussion Draft

BEPS Action 10:
Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions

February 3, 2015

Mr. Andrew Hickman
Head of Transfer Pricing Unit
OECD, Centre for Tax Policy and Administration
By email: TransferPricing@oecd.org

Sir,

We are pleased to comment the public discussion draft BEPS Action 10: Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions (the draft) through the consultation taking place from December 16, 2014 to February 6, 2015.

This document may be posted on the OECD website. Full credit goes to Robert Robillard, DRTP Consulting Inc.¹

1. The use of quoted prices in applying the CUP method

1.1. The draft suggests that quoted price are “the result of the interaction of supply and demand in the market for a certain quantity of a type of product at a specific point in time”.

1.2. This is what the economic theory teaches us all. But then, the economic reality sets in fairly quickly.

¹ Robert Robillard, CPA, CGA, MBA, M.Sc. Economics, is Senior Partner at DRTP Consulting Inc. and Tax Professor at Université du Québec à Montréal; 514-742-8086; robertrobillard@drtp.ca. He is also the Transfer Pricing Chief Economist at RBRT Transfer Pricing (RBRT Inc.) and a former Competent Authority Economist and Audit Case Manager at the Canada Revenue Agency.
1.3. Most commodity markets are occupied by a few highly specialized players who are also producers.

1.4. Many commodity markets are highly political in nature.

1.5. Most if not all modern commodity markets experience wild price swings in a relatively short amount of time.

1.6. These wild price swings bear no relationship whatsoever with the fundamental conditions surrounding the market (supply and demand being one of the many factors).

1.7. Crude oil, for instance, lost almost 50% of its value in 2014. This extreme price plunge has had nothing to do with “supply and demand” as it is defined in basic economic textbooks.

1.8. Similar observations can be made for any major commodity market (grains, softs, etc.) in the last 5 years where wild swings in prices have been the norm, not the exception.

1.9. All these massive price fluctuations would have created huge “arm’s length ranges” in alleged comparable uncontrolled prices in relatively short amounts of time.

1.10. This fact of life simply does not represent what parties dealing at arm’s length would have agreed upon.

1.11. Commercial parties (related or not) manage their risks. This is recognized by the guidelines.

1.12. All this to say, that commodity hedging should be included in any discussion that aspires to include quoted prices for the purpose of an arm’s length transfer pricing determination of a given commodity transaction.
2. **The deemed pricing date rule for commodity transactions**

2.1. In light of the above-observations, it makes no sense whatsoever to put forward such a rule considering the crucial role played by hedging in the pricing of commodities.

2.2. Although there may be “considerable evidence that commodity transactions generally tend to be priced by reference to the quoted price within a quotation time period close to the time of shipment”, as alleged by the draft, there is also considerable evidence to the effect that firms take steps to minimize and manage their pricing risks in any given markets.\(^2\)

2.3. Even the OECD recognizes this fact.\(^3\)

2.4. The “deemed pricing date” rule is about partial re-characterization of a controlled transaction by a tax administration.

2.5. We are therefore clearly opposed to this rule which will create tax disputes and tax litigations both between taxpayers and tax administrations and among tax administrations.

3. **Conclusion**

3.1. More practical avenues are available for tax administrations to deal with the issues highlighted in the draft.

3.2. If and when the information is not available for a specific commodity transaction or series of transactions, the simple use of monthly or quarterly price averages or medians should be considered.

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\(^2\) Those who make their business of not hedging their risks usually go belly up (Barings Bank and Enron come to mind) or suffer heavy losses (Société générale and UBS come to mind).

\(^3\) See the OECD Transfer Pricing Guidelines (July 2010) and, more recently, the *Public Discussion Draft BEPS Actions 8, 9 and 10: Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterisation, and Special Measures)*, December 1, 2014 to February 6, 2015, which discusses at length risk management and control.
3.3. These types of procedures would in fact revert back to the methodology discussion on the arm’s length range included in Chapter III of the OECD Guidelines.  

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February 3, 2015

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4 In this context, the interquartile range and the median would result from a specific series of quoted prices from the relevant time-period.
Dear Mr. Hickman:

We appreciate the opportunity to offer commentary on the OECD’s discussion draft on the transfer pricing aspects of cross-border commodity transactions. We also would like to convey our interest in further consultation related to this proposal, should the need arise. Please see our initial commentary below:

1. From our experience, companies that engage in intercompany “commodity transactions” often do so with high frequency, which makes it overly burdensome to evaluate each commodity transaction using the CUP method in isolation. As such, it may be useful to explicitly allow for the application of statistical sampling procedures in application of the CUP method. For example, see Rev. Proc. 2011-42 issued by the Internal Revenue Service, which provides guidance on the use and evaluation of statistical samples and sampling estimates related to application of the CUP method under the US’s transfer pricing regulations.

2. As mentioned in the discussion draft, companies that engage heavily in the purchase and sale of commodities (both internally and externally) often have their own internal logistics services functions (e.g., freight, rail or ocean transportation) and/or execution services functions (e.g., trade execution commissions) that contribute to the overall price for the intercompany transfer of the commodity. Often the remuneration for these logistics and execution services are embedded within the final price agreed upon by the intercompany buyer and seller related to the transfer of the commodity. For example, the price for 5 lbs. of coffee beans quoted on the Chicago
Mercantile Exchange (“CME”) typically has two components: (1) the price of the commodity; and (2) the fee to transport that commodity to Chicago. Should the coffee beans require delivery to a different location, the transportation component of the price must be adjusted to account for the addition or reduction of transportation cost associated with the new delivery location. If the transportation services are performed by a related party, the transportation service price component of the coffee bean transaction must also be evaluated and determined to be arm’s length. Testing the arm’s length nature of each transportation transaction is likely overly burdensome and sometimes may not be possible due to the lack of available and reliable CUP data. However, if the overall intercompany logistics/transportation function can be evaluated and tested to be arm’s length, it can be assumed that the intercompany transportation service component of the coffee bean example would also be arm’s length. This type of approach can also be used to test the arm’s length nature of the intercompany commissions for execution services.

3. Adjustment examples:

For many taxpayers, the application of the CUP method for purposes of testing commodity transactions may be unclear. We suggest including a rather simple example of how a commodity transaction would be tested using a quoted price, which can also serve as the base case for presenting examples of common adjustments. See below for suggested “base case” example (which leverages the example in Chapter II of the existing Transfer Pricing Guidelines):

a. On January 28th, 2014, a company located in Chicago IL purchases 1 lb. of coffee beans from a related party in Columbia for $4.00. The coffee beans sold in the intercompany transaction are of a similar type, quality and quantity as those traded on the Chicago Mercantile Exchange (“CME”). The CME’s low and high spot price of a 1lb lot of Columbian coffee beans was from $3.991 to $4.004 on the same day. Also, assume both prices are inclusive of the necessary fees to transport the beans from Colombia to Chicago (e.g., transportation, insurance, duties/taxes) and no other material differences are found between the controlled and uncontrolled transactions. Based on these facts, the controlled transaction is comparable to the uncontrolled transactions reflected by the quoted prices, and the controlled price is within the high and low prices quoted on the commodity exchange; therefore the intercompany transaction is considered arm’s length.

b. Other Common Adjustments:

i. Quantity Adjustment: On January 28th, 2014, a company located in Chicago IL purchases five metric tons (“mts”) of coffee beans from a related party in Columbia for $44,080.00. The coffee beans sold in the intercompany transaction are of a similar type and quality (but
not quantity) as those traded on the Chicago Mercantile Exchange. The CME’s low and high spot price of a 1 lb. lot of Columbian coffee beans was from $3.991 to $4.004 for the same day. The CME only trades in 1 lb. lots so the contract price of $44,080.00/5mts must be converted to a market-weight price (i.e., $44,080.00/5mts = $8,816.00/mt and 1mt = 2,204lbs, so $8,816.00/2,204lbs = $4.00/lb.). Again, assume both market-weight prices are inclusive of the necessary fees to transport the beans from Colombia to Chicago (e.g., transportation, insurance, duties/taxes) and no other material differences are found between the controlled and uncontrolled transactions. Based on these facts, the controlled transaction is comparable to the uncontrolled transactions reflected by the quoted prices, and the controlled price is within the high and low prices quoted on the commodity exchange; therefore the intercompany transaction is considered arm’s length.

1. **Additional Commentary:** This type of adjustment is very basic and the conversion factors are readily available on the internet for purposes of auditing those factors used. Perhaps it would make sense to publish some standard conversion factors to ensure consistency.

ii. **Basis Adjustment:** On January 28th, 2014, a company located in New Orleans, LA purchases 1 lb. of coffee beans from a related party in Columbia for $3.95. The coffee beans sold in the intercompany transaction are of a similar type, quality and quantity as those traded on the Chicago Mercantile Exchange. The CME’s low and high spot price of a 1 lb lot of Columbian coffee beans was from $3.991 to $4.004 for the same day. Also, assume the quoted prices on the CME are inclusive of the necessary fees to transport the beans from Colombia to Chicago (e.g., transportation, insurance, duties/taxes) and no other material differences are found between the controlled and uncontrolled transactions. To test this transaction an adjustment must be made related to the freight/transportation reflected in each price related to the different delivery destinations (i.e., Chicago vs. New Orleans). As stated above, the spot price quoted on the CME includes “the necessary fees to transport the beans from Colombia to Chicago; however, the controlled price reflects transportation cost to New Orleans. As such, an adjustment must be made to the CME quoted prices to reflect delivery to New Orleans instead of Chicago. The adjustment in freight price of a 1 lb. lot of coffee beans from Columbia for delivery to New Orleans is negative $0.05 (i.e., it is $0.05 cheaper to deliver a 1 lb. lot of beans from Columbia to New Orleans, than it is to deliver the same lot of beans to Chicago).
Therefore the low and high spot price of a 1 lb. lot of Columbian coffee beans purchased on the CME, but with delivery to New Orleans is from $3.941 to $3.954. Based on these facts, the controlled transaction is comparable to the uncontrolled transactions reflected by the quoted prices, and the controlled price is within the adjusted high and low prices quoted on the commodity exchange; therefore the intercompany transaction is considered arm’s length.

1. Additional Commentary: There are certain companies that provide information related to prices of commodities as well as the incremental cost differences associated with delivery to different locations. For example, commodity brokerage firms, such as The SCB Group, provide such information related to biodiesel fuels, which are commonly used in transaction pricing between both related and unrelated parties. Also, third-party freight costs may be in place with suppliers and will be useful as a starting point for intra-group charges; however, the freight activity may be across multiple locations requiring some kind of unitary adjustment or functional split of the costs across each location.

iii. Product-Type Adjustment: On January 28th, 2014, a company located in New Orleans, LA (Company X) purchases 1 metric ton of standard cocoa butter from a related party in Ghana (Company Y) for $5,000. The cocoa butter is purchased in blocks and is to be made from African cocoa beans, which are of similar type, quality and quantity to cocoa beans traded on the Intercontinental Exchange (“ICE”). The ICE trades only cocoa beans (i.e., it does not trade cocoa butter, liquor or powder) in metric ton lots; therefore, when Company Y sells cocoa butter, liquor or powder to related or unrelated parties, it typically adjusts the price of the cocoa beans quoted on the ICE using multipliers published by independent sources. The ICE’s low and high spot price for a metric ton of African cocoa beans was from $2,500.00 to $2,550.00 for the same day. Also, assume both prices are inclusive of the necessary fees to transport the beans/liquor from Africa to New Orleans (e.g., transportation, insurance, duties/taxes) and no other material differences are found between the controlled and uncontrolled transactions. To test this transaction, a product-type adjustment must be made in order to account for the product differences between the cocoa beans traded on the ICE and the cocoa butter purchased in the intercompany transaction. Company Y uses information from an independent source to determine that a multiplier of 2.0 should be used to adjust the ICE quoted price for one metric ton of African
cocoa beans to account for the lower yield and additional fee associated with making cocoa butter blocks.\(^2\) Therefore, the low and high spot price for one metric ton of standard African cocoa butter blocks purchased on the ICE is from $5,000.00 to $5,100.00. Based on these facts, the controlled transaction is comparable to the uncontrolled transactions reflected by the quoted prices, and the controlled price is within the adjusted high and low prices quoted on the commodity exchange; therefore the intercompany transaction is considered arm’s length.

1. **Additional Commentary:** Independent sources exist that can provide statistical data on the multipliers to use for these product-type adjustments (e.g., Commodities Risk Analysis LC provides such multipliers for cocoa beans). These sources are commonly used in transaction pricing between both related and unrelated parties.

We are happy to discuss the issues we have raised in this paper in more detail. Please contact Shiv Mahalingham at Shiv.Mahalingham@DuffandPhelps.com or Ryan Lange at Ryan.Lange@DuffandPhelps.com for more information.

\(^2\) The cocoa butter multiplier takes into account two primary factors: (1) Yield; and (2) Processing Fee. The yield accounts for the fact that creating one metric ton of cocoa butter requires more than one metric ton of cocoa beans. For purposes of this example the technical yield of cocoa liquor is 60%--said differently, it takes 1/6, or 1.667, metric tons of cocoa beans to produce 1 metric ton of cocoa butter. The second factor is the additional cost involved in processing the cocoa beans to make cocoa butter. In this example, it costs approximately $834 to process one metric ton of cocoa beans into cocoa liquor.
European Business Initiative on Taxation (EBIT)

Comments on the OECD Public Discussion Draft BEPS Action 10: Discussion draft on the transfer pricing aspects of cross-border commodity transactions
Dear Andrew,

EBIT is grateful for this opportunity to provide comments to the OECD on its Public Discussion Draft on “BEPS Action 10: Discussion draft on the transfer pricing aspects of cross-border commodity transactions” which was issued on 16 December 2014 (hereinafter “the Discussion Draft”).

- We generally support the OECD’s initiatives to provide more detailed guidance on the application of the CUP method in relation to commodity transactions as well as identifying common (reasonably accurate) adjustments to quoted prices. It should be noted that even with more detailed guidance on potential adjustments to quoted prices, the adjusted quoted prices should still be considered reference prices and not per definition the price to which the intercompany price should be adjusted to. This would lead to numerous transfer pricing adjustments imposed by tax administrations and would in absence of automatic corresponding transfer pricing adjustment mechanisms between jurisdictions result in double taxation. Also we would welcome guidance on the use of bandwidths/ranges from the reference prices in order to mitigate disputes with tax administrations.

- Furthermore preparing documentation supporting the reference prices and the adjustments to quoted prices can be an extensive and time consuming exercise for which MNCs may have to dedicate substantial internal/external resources. We would welcome that the OECD would refrain from the comment that: “the CUP analysis is generally the most appropriate transfer pricing method”. There are circumstances/situations where other transfer pricing methods can be applied in an equally reliable manner. For avoidance of doubt, with this additional guidance for cross-border commodity transactions, the commodities industry should not be subject to more stringent standards than other industries for transfer pricing documentation and it should not be implied that the CUP method is elevated to the primary method for this industry.

- The adoption of a deemed pricing date for commodity transactions between associated enterprises “in the absence of evidence of the actual pricing date agreed by the transacting parties” does not correspond to the complex economic reality of the commodities business: a commodity purchased at a certain point in time (X) with a future delivery date (X+3 months) will most likely already have been sold (X+15 days) in the meantime. Adopting a deemed pricing date (X+3 months) instead of the quoted commodity price on the pricing date (X) will open the door for undue influence / manipulation in the system. Deeming the delivery date as the pricing date for the contract is not only not evidenced in third party situations, it could also result in profits or losses are being recognized by an MNC for tax purposes, without any actual commercial profits.
or losses supporting such an adjustment. For example Company A sells to Company B at 100 for delivery at X+3 months. After 1 month Company B sells to its customer at 110 for delivery at X+2 months. In the case that at the shipping date (X+3 months) the market reference price is 120, the tax authorities could adjust the intercompany price from Company A to Company B to 120. The tax administration would allocate additional profits of 20 to Company A, although profits of 10 was never achieved by the Group as a whole. Therefore, the acceptance of a deemed pricing date could not only result in potential double taxation, but could also allow for tax administrations to tax non-existing Group profits. We strongly urge the OECD to reject the adoption of the deemed pricing date or ensure that its application is limited to very exceptional cases, e.g. in cases whereby the counterparties perform only very limited functions.

- Clarification / guidance is needed about what is considered to be “absence of evidence”: in a lot of countries there is currently not a specific requirement to document the purchases and sales of movable goods carried out with a signed contract. Tax authorities should accept that the actual execution of a transaction can be evidenced with other documents such as the order receipts, the conduct of the parties (in line with the functional and risk profile), the proposals and acceptance exchanged via e-mails, the transport documentation, the custom documentation evidencing the contract date, etc.

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

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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Andrew Hickman
Head of Transfer Pricing Unit,
Centre for Tax Policy and Administration
OECD

5 February 2015

Dear Sirs

Transfer Pricing Aspects of Cross-Border Commodity Trading

This submission is made in response to your invitation for comments on the Consultation Paper “BEPS Action 10: Draft on the Transfer Pricing Aspects of Cross-Border Commodity Trading” issues by the OECD on 16 December 2014. This response represents the views of ED&F Man Holdings Ltd (hereinafter “ED&F Man”).

ED&F Man is a UK headquartered commodity trading and financial service group with operations in over 60 countries. Our origins date back over 230 years. Our commodity business primarily trades in physical sugar, coffee and molasses, and also carries out hedging of the physical commodity to manage price volatility.

Based on our experience of operations in the soft commodity business we make the following comments.

ED&F Man welcomes the OECD recognition that origin countries should be fairly rewarded for the products produced in those countries. This in turn requires the need to develop rules to prevent MNC’s engaging in transactions which would not, or would only very rarely, occur between third parties which would otherwise result in BEPS. In this respect we support transfer pricing rules being used to ensure each party to a transaction receives relevant reward for the work undertaken.

However, the consultation paper has some fundamental errors in understanding how some commodity businesses operate. In particular:

- the CUP approach will lead to volatile results where a group has a procurement company in a location; and
- the commercial necessity of hedging to manage price volatility is not included in the discussion.

ED&F Man uses a local entity to procure commodities in an origin country and then export, selling to other group companies globally. When procuring, the price paid for commodities will where possible be linked to an exchange price, or if no exchange exists as in the case of molasses, at local market price. If ED&F Man immediately sold on a back to back basis to an overseas affiliate, this local market price would be the basis of the CUP used to value the transaction. However, in reality
there is a time delay between acquisition and export resulting in price volatility. The impact of the consultation paper is to move this price volatility into origin companies. An increase in prices will give the potential for local profits, but just as easily there could be a fall in prices resulting in local losses.

To manage the price volatility ED&F Man hedge their global physical commodity positions (where a relevant exchange exists). Hedging will be carried out centrally because the skills needed in procurement and those for hedging a global commodity book are not the same. They are carried out in different locations by different employees. The potential risks that arise from incorrect hedging limit where ED&F Man permit this activity within the group. This has nothing to do with BEPS, but is a commercial decision on how ED&F Man manages its risks.

Hedging is also carried out centrally so that global long and short positions can be offset thereby taking advantage of internal economies of scale reducing the costs of hedging. Use of such umbrella accounts (akin to cash pooling) is common.

In many of the countries in which we operate tax legislation does not permit the profit and loss from hedging to be treated symmetrically with price fluctuation on associated physicals.

An origin company whose main activity is procurement is providing a service to other group entities. Having the option to reward such companies using a TNMM method will guarantee local profits. Bearing in mind we have purchased the commodity using exchange or market related prices this should not result in BEPS so long as the TNMM method correctly rewards the origin company for services provided. A choice of methods is therefore recommended for commodity traders such as ED&F Man.

If the OECD continues to pursue CUP as the only method to price physical commodity transactions, there is an imperative need for simple legislation in relation to the tax treatment of commodity hedging. This includes legislation relating to a recharge of profits and losses on hedging transactions when the hedge is carried out centrally under an umbrella account.

Other issues arise from the consultation paper including:

- the use of a deemed pricing date does not fit in with the commercial reality of some transaction. For example when a third party customer has the ability to fix prices at any time, or when pre-financing is involved;
- differentials are never purely standard market amounts, but based on one to one negotiations with customers; and
- the increased compliance burden that will arise from the use of CUP.

However, we have limited our comments to the commercial implications arising from the use of CUP because the volatility that will arise from the Consultation Paper cannot be what is intended.
I trust the comments are useful, but if you would like to discuss further please feel free to contact me.

Yours faithfully

Paul Parness
Head of Tax, ED&F Man Holdings Limited
Dr. Andrew Hickman  
Head of Transfer Pricing Unit  
Centre for Tax Policy and Administration  
By email

**SUBJECT: DISCUSSION DRAFT ON THE TRANSFER PRICING ASPECTS OF CROSS-BORDER COMMODITY TRANSACTIONS**

6 February 2015

Dear Dr. Hickman,

EY appreciates the opportunity to provide comments on the discussion draft regarding BEPS Action 10: “Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions” (the Discussion Draft) as released by the OECD on 16 December 2014. This letter presents the collective view of EY’s global transfer pricing network.

**General remarks**

Most of the newly proposed elements of the Discussion Draft relate to guidance for the application of the CUP method. Given the importance of the topic, we also provide comments on sections and paragraphs that are not explicitly covered in the document, like the use of the so called sixth method and similar approaches, and administrative practices.

**Key comments**

Our key comments with respect to the Discussion Draft, as further elaborated upon in the “detailed comments” section of this letter, can be summarized as follows:

- The Discussion Draft is the outcome of work performed by Working Party No. 6 within the mandate of Action 10 of the BEPS Action Plan. The Action Plan refers to “rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties.” The Action plan states that this “will involve adopting transfer pricing rules or special measures to … (iii) provide protection against common types of base eroding payments.” We believe commodity transactions in general should not be categorized as such transactions. Potential remedies for practical difficulties in the application of the arm’s length principle should therefore be dealt with outside the context of BEPS. If specific measures would be suggested for commodity transactions in a BEPS context they should be carefully drafted and limited to prevent overkill for plain vanilla commodity transactions.

- The Discussion Draft introduces in fact a reversal of the burden of proof motivated by the lack of ability of tax administrations to verify the pricing date. The Discussion Draft does not elaborate on the background of this inability. The introduction of a requirement to evidence the contractually agreed date is a deviation from the contract being the starting point of the transfer pricing analysis. Such deviation from contracts should only be allowed in exceptional circumstances with the burden of proof on the tax administrations. Furthermore, safeguards should be put in place when introducing an anti-abuse method like the deemed pricing date. For example, when applying a deemed date, such application should not be limited to transactions which would lead to a favorable outcome for the tax authority applying it.
Commodity prices may change rapidly, even intra-day. The Discussion Draft rightly mentions that the term “pricing date” refers to a specific date or a time period (e.g., a specified range of dates over which an average price is determined) selected by the parties to determine the price for the commodity transactions. This business practice should be accepted and parties should not be forced to use a specific date, but should be allowed to use a reference period that is commonly used in the industry.

Upon audit, tax administrations may request a taxpayer to prove out the arm's length character of the transfer pricing policy applied. Especially when applying an outcome testing approach, taxpayers should be allowed to substantiate the arm's length character by analyzing a certain subset of transactions (e.g., a set of the most important transactions) and/or by applying a statistical sample. Requiring testing for documentation purposes for all transactions may be overly burdensome and thus contrary to paragraph 5.6 of the OECD Guidelines that says that a “tax administration should take great care to balance its need for the documents against the cost and administrative burden to the taxpayer of creating or obtaining them”.

While in some circumstances the CUP method will be the most appropriate method for commodities transactions, this may not always be the case. It may follow from the analysis of facts and circumstances, in particular the functional analysis, that another method would provide a more reliable outcome for the remuneration of the functions performed, assets used and risks assumed. The mere fact that a transaction involves commodities does not mean that a proper functional analysis, including in particular the analysis of the risks assumed, should not be performed.

There are commodity transactions that occur between third parties that are not based on the commodity prices prevailing on an index, albeit that such an index may exist, such as metal streaming transactions. Failure to consider the existence of these types of agreements and insisting on implementing an index based CUP effectively ignores the relevant commercial and financial contributions of the various entities within the value chain.

In the paper on transfer pricing comparability data and developing countries issued by the OECD in March 2014, the OECD refers to the so-called sixth method as an “approach to identify arm’s length prices or results without reliance on direct comparables”. We recommend that the OECD clarify that the sixth method and similar methods are anti-abuse rules rather than a proxy for an arm’s length method, and that application of the arm's length principle should not be overridden without proper justification.

More detailed comments with respect to the Discussion Draft are presented below. If you have any comments or questions, please feel free to contact any of the following:

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Yours Sincerely,
On behalf of EY

John Hobster / Ronald van den Brekel
Detailed comments

The Discussion Draft mentions it is preferred that comments be provided with references to paragraph numbers. Therefore, we have structured our comments in accordance with the structure of the Discussion Draft itself and included references to specific Chapter II of the guidelines, we also provide comments on sections and paragraphs that are not explicitly covered in the document, like the use of the so called six-method and similar approaches, and administrative practices.

§ I.2. We concur that expanding the OECD guidance regarding the intercompany pricing of commodity transactions will provide a long-term benefit to multinational taxpayers and tax administrations alike. However, we think that parallel to emphasizing the difficulties encountered by tax administrations, the Discussion Draft should also acknowledge that the intercompany structures employed by many multinationals involved in a commodities-related business generate strong incentives for arm’s length behavior among the related parties on the opposing ends of the transaction. Typically transactions will occur in an environment that will not be considered to involve base erosion and profit shifting.

Multinationals frequently employ separate trading entities that are responsible for purchasing commodities from the producer country and selling to the user country. These trading entities usually also conduct similar transactions with unrelated parties. The transactions are typically conducted by individual traders whose performance and financial incentives are based on their individual trading book, not on the performance of the multinational overall. Consequently, traders have strong incentives to engage in arm’s length behavior and to extract the best possible price to maximize profit for their book regardless whether they are transacting with an affiliate or an unrelated party. In addition, many traders will have the ability to buy from and sell to unrelated parties, creating real commercial tension in the transactions.

Second, many countries (and specifically developing countries) already exercise strong governmental control over the commodities production process for reasons that are unrelated to BEPS. For example, multinationals that desire to explore for crude oil or natural gas resources, typically have to enter into an agreement with the host government that stipulates the product royalty. In other circumstances, host governments publish an “official selling price” which binds sellers exporting the relevant commodity. In fact, many exporting countries, particularly energy commodity exporters, conduct all exports through a government-held company. Moreover, strong government regulation over many commodities businesses is not limited to developing countries. For instance, it is not uncommon for government regulators to set electricity prices in developed countries. Potential remedies for practical difficulties in the application of the arm’s length principle should therefore be dealt with outside the context of BEPS. If specific measures would be suggested for commodity transactions in a BEPS context they should be carefully drafted and limited to prevent overkill for plain vanilla commodity transactions.

With respect to the specific transfer pricing issues raised by this § I.2, we would also like to make the following comment. While adjustments for product quality, transportation and delivery terms, as well as others, are very common, it is usually the case that upon detailed audit each adjustment can be assessed relative to an unrelated party benchmark. However, it may require significant resources on part of both the taxpayer and the tax auditor to do so. Upon audit, tax administrations may request a taxpayer to prove out the arm’s length character of the transfer pricing policy applied. Especially when applying an outcome testing approach, taxpayers should be allowed to substantiate the arm’s length character by analyzing a certain subset of transactions (e.g., a set of most important transactions) and/or by applying a statistical sample. Requiring the testing for documentation purposes for all transactions may be overly burdensome.

§ I.3. The paragraph refers to other methods. In the paper on transfer pricing comparability data and developing countries issued by the OECD in March 2014, the OECD refers to the so-called sixth method as an “approach to identify arm’s length prices or results without reliance on direct comparables”. We recommend that the OECD clarify that the sixth method and similar methods are anti-abuse rules rather than a proxy for an arm’s length method, and that application of the arm’s length principle should not be overridden without proper justification.
§ 1.6/1.7. The Discussion Draft states that the OECD has taken into account the concerns expressed by some tax administrations regarding the difficulty in obtaining information to “verify the price of commodities, including pricing date conventions and comparability adjustments.” In our view, the mere fact that tax administrations currently may not have access to relevant information or lack the expertise in verifying the information in itself should not be a reason to depart from the arm’s length principle. It may be worth analyzing how information available to taxpayers can be shared with tax administrations as well. Further, the OECD may consider supporting the capacity building in the relevant countries, rather than moving away from the sound application of the arm’s length principle. We welcome the statement that research may be performed under the OECD’s Tax and Development Programme. Furthermore, introduction of (bilateral) safe harbors may be considered, as long as taxpayers have the freedom to deviate from these based on the arm’s length principle. Moreover, the introduction of a definition of “commodities” or alternatively a list of commodity goods that would be subject to these guidelines could help create additional certainty for taxpayers.

§ II.8. We suggest putting more nuances around the language stating that the CUP method would generally be the most appropriate transfer pricing method for commodity transactions or replacing it with language stating that the CUP method may be applied if based on the functional analysis and the availability of data it can be supported as the most appropriate method. Not all commodity transactions are identical. While many commodities are publicly traded, some are not, and pricing data for a CUP application may not be available. Furthermore, many taxpayers may engage in commodity transactions that include a value-added component (e.g., metal concentrates processed to some degree). In such instances and based on the functional analysis, the taxpayer may conclude that a method other than the CUP method is the most appropriate one. We also refer to our comments below.

§ II.12.2. The Discussion Draft does not define the “relevant period” from which pricing information may be utilized to price a transaction. Commodity exchanges provide tick data so prices can literally change by the second. From a practical perspective, it is difficult to pinpoint the exact instance in time when a pricing decision was made. The Discussion Draft rightly mentions that the term “pricing date” can refer to a specific date or a time period (e.g., a specified range of dates over which an average price is determined) selected by the parties to determine the price for the commodity transactions. This business practice should be accepted and parties should not be forced to use a specific date, but should be allowed to use a reference period that is commonly used in the industry.

While material differences (e.g., product quality or the geographical location of the sale) should be adjusted for when possible, a number of inputs into a pricing formula may require substantial effort to corroborate based on market data. Hence, taxpayers should have the option to support the elements of a transaction by reference to a wider trading window rather than to a specific day price.

The Discussion Draft should clarify that if commodity-based transactions take place between related parties that do not occur, or occur only infrequently, between unrelated parties, that in itself does not mean that these are not arm’s-length.

A good illustration of this might be a take or pay contract, where a global mining group embarks on a project to develop a mine after conducting significant exploration. Having provided the funding for establishing the mine, the group may wish to secure all of the output of the commodity in advance. In order to manage commodity price risk across a range of commodities, the group may choose to centralize the risk in a particular entity that will undertake the significant risk assumption and management decisions for the MNE group as a whole throughout the mine life cycle. Whilst individual prices for the commodity may be available on an exchange, the existence of a long-term offtake agreement and the significant risk assumption and management related functions should not be ignored merely because the commodity is one for which a price quoted on an exchange is available. Therefore, another method than the CUP method may be the most appropriate method in this case.

It is further noted that there are commodity transactions that occur between third parties that are not based on the commodity prices prevailing on an index, albeit that such an index may exist. Examples exist in financing transactions with
independent third parties, such as metal streaming transactions. A streaming transaction is an approach to financing mining activities, usually development-stage activities where financing is provided by a metals streaming company (MSC) to a mining operating company. Streaming transactions may be used to finance a new acquisition or an expansion or development of an existing mine or mine site. While there are a number of structural variations of this arrangement, an MSC may advance funds, as a down-payment for or in exchange for the right or commitment to acquire a percentage of a commodity for an extended period at a discount from the prevailing spot rate. It is equally possible to use streaming transactions in an intra-group financing transaction.

The allocation of risk is a significant consideration in commodity related industries. Therefore, a full functional analysis should be applied before concluding the CUP method is the most appropriate method. Over-emphasis on the physical commodity and under-emphasis on the risk management function should be avoided. The recent volatility in the oil price is a great example of the situation where the split of risk between the time that the commodity is extracted and the time that it is sold should not necessarily be borne by the entity extracting the oil. Should an oil extraction company have stockpiled oil before the oil price dropped so dramatically towards the end of 2014, it would currently be suffering adversely as it would need to sell its production at the lower market prices currently prevailing. The role of the various parties in relation to the decisions regarding production and stock levels and the point in time at which intercompany/market sales take place should be taken into consideration.

Failure to consider the existence of these types of agreements and insisting on implementing an index based CUP would effectively ignore the relevant commercial and financial contributions of the various entities within the value chain.

§ II.13. While commodity prices can fluctuate after the date of the transaction, it is important to respect the taxpayer’s decision how to allocate the price risk. If the seller has committed to a price before the shipment date, but the price appreciated by the time of shipment, the buyer should retain the upside given the arrangement is demonstrated to have substance. In the context of commodity transactions the substance behind allocations of risk should be easier to verify given that multiple transactions occur each year. If the buyer in the aforementioned example did not get the upside during price appreciations but was also protected from the downside during price depreciations, this could support the substance behind the risk transfer. In our experience in the commodity sector, contemporaneous records are typically kept of the arrangements between parties (both internal and external). However, these may be reflected through traders’ day-books or e-mails rather than formal contracts. Such high level documentation is not uncommon between unrelated parties. If the OECD would introduce a deemed pricing date, we recommend that the OECD clarify in the guidance that these contemporaneous records should be accepted as reliable evidence of the actual (as opposed to deemed) pricing date as well.

§ II.14. The pricing date should generally be the date at which price and title risk transferred from the buyer to the seller rather than the date at which the title transfers or the payment is made. The bill of lading date may or may not be a good approximation depending on the time elapsed from the sale to the loading of the cargo. As noted above, decisions how to allocate price risk should be respected provided there is appropriate substance behind the arrangement chosen by the taxpayer and a clear agreed pricing date is determined and documented. The burden of proof for deviating from the agreed pricing date should be on the tax administration. Furthermore, safeguards should be put in place when introducing methods relying on deemed pricing dates. For example, when applying a deemed date, such application should not be limited to transactions which would lead to a favorable outcome for the tax authority applying it.

We further note that contingent pricing is very common in the industry. For example, two parties can price a transaction occurring into the future at an index price to be determined at this future loading date plus a fixed differential. In some cases the pricing may be based on a rolling average of specific trading dates or a more complex formula.
Providing for a safe harbor range consisting of several trading days before and after the transaction can reduce the relevance of pinpointing the exact transaction date when that is difficult to do and in line with common practice applied by traders for less liquid commodities.

§II.15. Applying the principles outlined in this proposed paragraph may be appropriate under a detailed audit of a commodity transaction but may be too burdensome in the context of preparing transfer pricing documentation, especially if no sampling is allowed and all transactions need to be tested individually. A safe harbor range around the transaction date may be more appropriate for documentation purposes.

§ II.17. Product quality and geographic location are by far the most important adjustments. However, we believe a comprehensive check list of adjustments may be unproductive and probably not possible to achieve as it is likely to be interpreted as a strict requirement by tax administrations to adjust for all factors listed and not to adjust for any factors that have not been listed. Ultimately, a facts and circumstances analysis needs to be performed to determine what the relevant adjustments on case by case basis are just as it is the case for non-commodity transactions.

To: Andrew Hickman, Head of Transfer Pricing Unit, Centre for Tax Policy and Administration (TransferPricing@oecd.org)

Introduction

The OECD released its latest draft on the public discussion of the transfer pricing aspects of cross-border commodity transactions on 16 December 2014 with comments invited by 6 February 2015. The comments provided below are prepared by the author as representative of Gazprom Marketing & Trading Ltd.

General Overview and High Level Thoughts

The seven pages of discussion and 5 paragraphs of proposed guidance to the OECD Transfer Pricing Guidelines risk oversimplifying the complexities of global commodities markets and transactions. Whilst the paper notes the main area of concern is from tax authorities in resource-rich developing countries, it makes no distinction for the differences between upstream commodity producers, commodity trading and those using commodities within their supply chain. Commodities are a foundation of the global economy and all companies have some exposure to commodity transactions and prices. Such widespread changes could have significant adverse implications on all sectors. Given the potential impact and range of the proposals, serious consideration is needed before any changes are made.

We are not convinced of the need for a separate set of rules applying the arm’s length principle for commodities transactions. Under the existing guidelines tax authorities already have the ability to challenge situations where they feel the outcome does not reflect an arm’s length price. In addition, Actions 8-10 of the BEPS project are already looking at amending those guidelines to provide further tools to challenge transfer pricing arrangements. Existing work on these areas, including risk and re-characterisation, should be concluded in order to provide a common approach for dealing with perceived transfer pricing abuses across all industry sectors, without the need for creating a different set of rules for just one area.

Further, we would note that the use of a quoted price, which in itself can be relatively arbitrary for the reasons discussed below, ignores the fundamental BEPS principles of aligning profits with substance and risks and ignores the role of the global value chain and value drivers within a business.

In our view this does not necessarily give an arm’s length outcome and in many cases could result in non-arms length and un-commercial outcomes.
More detailed comments are provided below in relation to the three topics raised in the draft.

**A. Use of a quoted commodity price**

The discussion draft proposes an addition to the current guidelines that “the CUP method can be an appropriate transfer pricing method for establishing the arm’s length price for the transfer between associated enterprises of commodities for which a quoted or public price is available (“quoted price”).” However, the commentary in the discussion draft goes further and states that “the CUP method would generally be the most appropriate transfer pricing method for commodity transactions”.

We would note that it does not necessarily follow that the potential availability of a quoted price should lead to the CUP being the preferred method. The quoted price is referred to as a “comparable uncontrolled arrangement represented by the quoted price” and is not in itself a comparable uncontrolled transaction. Under the existing transfer pricing guidelines (§2.15), “where it is possible to locate a comparable uncontrolled transaction, the CUP method is... preferred over all other methods”. Therefore, where there may be a quoted price but no comparable uncontrolled transaction, it would not follow that the CUP would also be the preferred method.

In practice, it is generally not the case that a quoted price will be the most appropriate and, in many cases, it could result in non-arms length and un-commercial outcomes. Whilst we accept that the use of quoted prices may be an appropriate reference point in certain cases, it will not be the most appropriate method in many others.

For example, where the quoted price transaction is significantly different from the relevant transaction then the difficulty of adequately adjusting for numerous comparability adjustments may mean the quoted price may actually lack comparability and is not the best approach. Alternatively, in an example of a largely integrated commodity trading business where one company buys the commodity and another sells, but they do so in an integrated manner, then a profit split may be more appropriate.

It is also very common and well accepted for commodities to be priced based on net back pricing which can start with either a hedged forward price or a third party sales price and then adjusts back for the various transport, import, processing etc. (in a similar way to the price adjustments). This may be different from the use of a quoted price but is still arms length.

Serious consideration is therefore needed to select the most appropriate method, and the OECD should avoid over reliance on the CUP method across the board – at the expense of potentially more reliable transfer pricing methods in certain cases.

**Alignment of reward with substance (i.e. functions, assets and risks)**

The quoted price ignores the overall economic result of the taxpayer which could result in non-economic allocations of profit/losses, especially in commodity trading where margins are generally low. It also ignores the fundamental BEPS and transfer pricing principles of aligning profits with substance, i.e. functions and risk management activities and does not achieve the stated aim to ensure that pricing reflects value creation.
In a trading business, value is created by matching sellers with buyers and by effectively managing price and other risks across the value chain – these activities are often performed in a central location that is not always in a producer location. This is because commodity traders need to locate themselves in mature markets (such as London or Geneva) which have the legal and banking systems, infrastructure and resources to optimise their business. It is often the case that the producing countries with developing economies are not able to offer these necessary benefits.

The proposal generally ignores the interaction of physical commodity prices with risk management strategies that companies may use to manage their commodity price risk. This can include financial transactions (hedges, options, swaps), consideration of spot versus futures/forward prices, portfolio hedging and other risk management techniques. Ignoring these would result in tax volatility across jurisdictions if the physical commodity and hedging activity are in different countries.

The OECD’s proposals could under reward this high value risk management activity. The proposals could also mean that price risk is borne by the producer location, who will receive related rewards. This would be the case even where it is an entity in a different jurisdiction that is performing the price risk management functions – which to us is contrary to the general direction of the BEPS project.

Take for example a commodity producer which is part of an integrated group that has a sales company that manages the group’s overall commodity price risk via a mix of forward sales prices and hedges. If the producer was to simply sell to the sales company at the prevailing spot price on the date of each transaction then, as the commodity price rises, the group’s profit remains unchanged but within that producer makes more profit and the sales company, who has a fixed selling price, makes less. Conversely, if the prices fall the producer makes less profit and the sales company more. Both are subject to tax volatility due to a commodity price volatility that doesn’t exist.

In the above example the sales company could enter into a separate derivative transaction with the producer to avoid that tax volatility. However, that can create different commercial issues and also tax issues (e.g. some countries may not recognise the derivative or apply a withholding tax on it). Alternatively, the purchase can be done based on a fixed price which reflects the hedged selling prices of the sales company. Such a “risk-managed” price is still clearly arms length albeit not a quoted price. Further, even if the group chooses not to hedge prices but someone monitors the price risk and makes the choice not to hedge, the same risk-managed price in the first scenario is also an arm’s length price in this case.

Overall the use of quoted prices creates significant uncertainty to both taxpayers and governments in terms of their tax revenues as commodities markets can be highly volatile. The proposals risk protecting the tax base of the producing country to the detriment of other parts of the value chain by ignoring the value created that is not reflected when using a quoted price as a CUP. Independent producers do use various techniques to manage price risk and therefore these should be accepted as arms length even if they are not based on a quoted price.

**Additional compliance burden**

The proposal underestimates the significant complexity that such a method would create in practice, particularly if it became the preferred approach as suggested. It will create a significant additional
compliance burden to those regularly dealing in commodities and which typically involves large volumes of transactions.

Index based pricing is time consuming to calculate and therefore adds a significant burden above the more traditional methods. It should also be borne in mind that pricing for commodities needs to be contemporaneous and accurate at the time of the transaction as the transaction price is needed for indirect taxes, duties, import declarations etc.

**Availability and choice of quoted price**

Just because there is an external index or price reference point for a certain commodity, it will not always be clear which reference point, if any, will be appropriate. For example:

- The same commodity may be priced using completely different indices depending on the buyer’s and seller’s own individual factors, their view of the relevant markets and how they manage their own pricing risk. For example long term gas contracts could be priced by reference to a global oil index (e.g. Brent) or alternatively by reference to a gas index (which in itself could be any of several gas local gas markets). The prices may be based on fixed future prices, depending on the availability of suitable financial markets, or adjusted spot prices and the adjustments themselves can then differ.

- There can be multiple markets for the same commodity (e.g. European gas) and all with different prices. It would be uncertain whether the price should be by reference to the place it was purchased, where the end sale is to be made or any of the jurisdictions it may transit through.

- Differences in liquidity between markets impact the suitability of quoted prices. There is a vast difference between liquid, openly traded and transparent commodity exchanges, through to less liquid regional markets and at the extreme price indices/reports. For example in LNG there are price reports available but these are generally informative but not reliable and therefore not suitable. The prices reflected in those reports are not readily achievable prices for a company and reflect a significant aspect of marketing activity and IP from customer relationships of the selling company to achieve those prices. A pricing report cannot be used in the same way as a quoted price for a much more liquid commodity like oil.

- Some sources such as price reports, unlike active exchanges, can be infrequent and therefore are either out of date, or involve an element of hindsight, neither of which is suitable for transfer pricing.

- There can be changes over time as new markets or indices are developed or certain markets become more suitable or commonly used.

- Certain commodity markets can be highly volatile and prices can fluctuate significantly even within the day raising questions of which prices to use (e.g. bid price, offer price, day high/low, average etc.).
B. Deemed pricing date

The draft proposes the adoption of a deemed pricing date for commodity transactions (based on shipping date) between associated enterprises in the absence of reliable evidence of the actual pricing date agreed by the parties to the transactions. This is intended to tackle the use of pricing date conventions which appear to enable the adoption by the taxpayer of the most advantageous quoted price.

Companies use a range of different pricing reference dates in both intercompany and third party agreements (spot rates, forward rates, daily average, monthly average etc. and not simply a spot price on the date of the transaction. These are normal and arms length and therefore should not be over-ridden by a deemed pricing date. Similarly, companies also enter into contracts for delivery at any time in the future which may be a fix price (based on futures prices), a floating price on delivery, or a mix. All of these are again common and arms length. Overall, deemed pricing data should not be used to replace the actual date of the transaction when that date is already defined as this would not be consistent with the arm’s length principle. In our view the need to change the date on a transaction is very rare.

Tax authorities should already have the ability to challenge cases were a price or arrangement is not arms length and, in principle, clarify that a taxpayer should not be able to pick a pricing date with the benefit of hindsight. As such, in our view this issue should not be a significant concern to tax authorities. However, the proposal places the onus on the taxpayer to provide reliable evidence of the actual pricing date and if not allows the tax authorities to deem an alternative reference date. In our view, the threshold of proof on the part of the tax authorities is too low and provides a relatively easy tool for the tax authorities to deem a different date, the consequences of which could be significant.

Whilst taxpayers should not be able to pick a pricing date with the benefit of hindsight, the tax authorities should equally not be able to challenge the pricing date, with the same benefit of hindsight, just because the commodity price may have been low at the date a price was agreed. It is reasonable for companies to enter into a transaction at any point of time, commodity prices fluctuate and taxpayers do not control commodity prices, they can go up or down.

Therefore, it should be made clear that tax authorities cannot use this freely but it should instead be a targeted provision to be used exceptionally in rare cases of abuse by taxpayers. Specifically, it should not impact commercial transactions where two parties have entered into an arm’s length transaction based on the prevailing market conditions.

Over use of this provision could result in numerous cases of either double taxation or potentially lengthy Competent Authority cases, as is the case with all potential transfer pricing adjustments.

C. Comparability adjustments to quoted prices

Although many transactions (whether they are with controlled or uncontrolled parties) involving commodities are set by reference to a quoted price, our experience is that in nearly all cases there will be an adjustment to the quoted price to reflect (as the paper acknowledges) many different commercial factors and considerations. In some arm’s length situations involving commodities the end price is the subject of negotiation between transacting parties – these negotiations may result in
a discount (or premium) being applied to the quoted exchange price. Recreating these negotiations and applicable discounts in an intra group scenario may be difficult, and is a reason why the CUP method may not be the most appropriate method in some circumstances.

It would therefore be rare for a quoted price in isolation to represent a comparable uncontrolled price. Although the paper makes references to making comparability adjustments the fact that this is confined to two paragraphs at the end of the document with no real guidance is a concern that perhaps the OECD have oversimplified what precisely a quoted price represents in an arm’s length arrangement.

As discussed above, the concept of using a quoted price for the underlying commodity is extremely complex in itself. The level of complexity, and consequently the administrative burden, is increased even further if we then start to prescribe a detailed list of adjustments to that price. There are potentially a huge number of adjustments which can differ depending on the commodity, the processing and logistics steps it requires, the location of the commodity, the place of processing etc. In our view it is unrealistic to prescribe such adjustments.

In the case where a CUP based on quoted prices can be applied then, as with all other matters, it should be left with the taxpayer to ensure that such adjustments and the resultant price of the commodity transaction are arm’s length. The adjustments should not be based on a prescribed formula set by a tax authority (or the OECD). As discussed above, if the tax authority subsequently wishes to challenge the taxpayers pricing it has the normal courses of action to do so, e.g. MAP.

These comments have been prepared by:

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3 February 2015

Dear Andrew,

**OECD Public Discussion Draft BEPS Action 10: Discussion draft on the transfer pricing aspects of cross-border commodity transactions**

Grant Thornton International Ltd, with input from certain of its member firms, welcomes the opportunity to comment on the OECD discussion draft issued on 16 December 2014. We appreciate the work that the OECD has undertaken on the wider BEPS project and would like to make the following comments on the draft discussion points and proposals.

**Introduction**

- The comments below do not relate to any specific paragraph, but rather provide some additional context which should be considered in this process.

- Participants in the commodity sector are varied – in the case of the resources sector, these vary from mineral rights owners, large multinational mining houses, processors and beneficiators, logistics operations and commodity traders to governments. As much as the sector can be highly regulated and capital intensive, it is also very entrepreneurial and all parties should be remunerated for their risks taken, intellectual capital provided and funding injected on an appropriate basis. In dealing with commodity prices, it is therefore critical that the wider BEPS project give specific consideration to the wider commercial and tax environment that makes up the developing country landscape.

- Developing economies should not be able to 'have their cake and eat it'. If the position is that commodities must be remunerated at a market price, then full market terms should conversely apply to everything – interest payable, technical fees, administrative and management fees, royalties, etc. There should also be free remittance of funds and withholding taxes should be appropriate. A realistic scenario is a taxpayer in a developing economy that pays corporate tax on its profits, has its tax deductions relating to related party charges limited, pays some type of mining royalty tax on its production or sales. Whenever this taxpayer wishes to remit funds to its non-resident related party, withholding taxes are applied and there are sometimes restrictions on the remittance of funds, whether they are for expenses that are being paid or capital that should be returned (loans or share capital). These developing economy 'fiscal challenges', along with other political, labour and economic interventions, discourages investment and will harbour informal and illegal trade. This does not just apply to the mining sector.

- Withholding taxes are particularly problematic in African countries, especially when domestic legislation is being used to override treaty relief.
**Proposed additions to Chapter II of the transfer pricing guidelines**

The use of the comparable uncontrolled price (CUP) method for pricing commodity transactions and the use of quoted prices in applying the CUP method

In paragraph 8, it is stated that the CUP method using a quoted price would 'generally' be the most appropriate transfer pricing method for commodity transactions. Many industry participants may welcome the certainty that proposed recommendations could provide. We are encouraged by the use of the word 'generally', as there will still be circumstances where the CUP method will not apply and alternative methods would be better suited.

**Recommendation** – Importantly, the concept of a contract miner or processor/beneficiator should not be ignored. As much as we are supportive of proposals to ensure that pricing reflects value creation, thereby protecting the tax base of commodity dependent countries, the sound principles of risk and reward should be borne in mind. Therefore, there should still be room to use other transfer pricing methods to remunerate a party on an arm’s length basis if they are more appropriate in the circumstances. The proposals should therefore make this very clear, as we would be concerned that certain jurisdictions may adopt a 'CUP only' approach.

In paragraph 9, the Draft correctly points out that quoted prices are not set by a single individual or entity (except in the case of governmental price control), as they are the result of the interaction of supply and demand in the market for a certain quantity of a type of product at a specific point in time. It should however be considered that the quoted reference price is not always a pure market price. In a true arm’s length environment, traders will trade above or below that price, which trade will then in turn impact on or determine the subsequent price level. Certain events that take place during any given day could have a significant impact on the reference price at any point during that day.

**Recommendation** – We would propose that a price range for the day in question be established and published, which range would be between the lowest and the highest price traded for the day. It could be considered to develop and interquartile range, but this may become administratively burdensome for all parties concerned. An alternative could be the average trading price for the day, which in our opinion, would be far more reflective that using a closing price on a particular day.

Deemed pricing date for commodity transactions

Paragraph 15 proposes the insertion of a paragraph 5 into Chapter II of the Transfer Pricing Guidelines. The essence of the proposal is that in the absence of reliable evidence of the actual pricing date agreed by the associated enterprises in the controlled commodity transaction, tax administrations may deem the pricing date for the commodity transaction to be the date of shipment as evidenced by the bill of lading or equivalent document depending on the means of transport. Using the shipment date may artificially either work for or against the taxpayer (and conversely, for or against the revenue authority). As a result, this approach may incentivise inappropriate behaviour from either the taxpayer or the revenue authority. As an example, if using the shipment date will result in the taxpayer achieving a lower taxable profit, it may purposely ignore the factual evidence and even destroy it. Similarly, if the shipment date will result in an increased tax burden for the taxpayer, a revenue authority may unduly focus on that date and dismiss factual evidence to the contrary.

**Recommendation** – It may be worthwhile to explore some type of averaging mechanism which will discourage such behaviour.
Potential additional guidance on comparability adjustments to the quoted price

No specific comment or recommendation.

Closing comments
Critical to the effectiveness of the proposals, will be the ability to adequately deal with the many different adjustments that could possibly be made to the quoted price of the commodity in attempting to attain a comparable position. Clear guidance will be an imperative to its adoption.

We would be pleased to expand on any of the points raised here. Please contact AJ Jansen van Nieuwenhuizen, Partner for Grant Thornton South Africa at aj@za.gt.com for any further details.

Yours sincerely

Global head - tax services
francesca.lagerberg@gti.gt.com
6 February 2015

VIA E-MAIL

Mr. Andrew Hickman
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development
2, rue André-Pascal
75116 Paris
France
TransferPricing@oecd.org

Re: Comments on Discussion Draft on BEPS Action 10: Transfer Pricing Aspects of Cross-Border Commodity Transactions

Dear Mr. Hickman:

The International Alliance for Principled Taxation (IAPT or Alliance) is a group of major multinational corporations based throughout the world, and representing business sectors as diverse as consumer products, media, mining, telecommunications, oilfield services, transportation, computer technology, energy, pharmaceuticals, entertainment, software, IT systems, publishing, and electronics. The group’s purpose is to promote the development and application of international tax rules and policies based on principles designed to prevent double taxation and to provide predictable treatment to businesses operating internationally.

The Alliance appreciates the opportunity to provide input to the OECD with respect to its Discussion Draft on BEPS Action 10: Transfer Pricing Aspects of Cross Border Commodity Transactions released on 16 December 2014. Our comments are set forth in the Annex to this letter.

We look forward to the opportunity to participate in the consultation to be held on 19-20 March 2015 with respect to this topic and would appreciate an opportunity to speak at the consultation. We also

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1 The current membership of the IAPT is made up of the following companies: Adobe Systems, Inc.; Anheuser-Busch InBev NV/SA; A.P. Møller-Mærsk A/S; AstraZeneca plc; Baker Hughes, Inc.; Barrick Gold Corporation; BP plc; Chevron Corporation; Cisco Systems, Inc.; ExxonMobil Corporation; Hewlett-Packard Company; Johnson Controls, Inc.; Microsoft Corporation; Procter & Gamble Co.; Reed Elsevier plc; Repsol S.A.; Sony Corporation; Texas Instruments, Inc.; Thomson Reuters Corporation; Tupperware Brands Corporation; and Vodafone Group plc.
stand ready to respond to any questions or to provide further input as the work of the OECD on this item continues.

Sincerely yours on behalf of the Alliance,

Caroline Silberzein
Baker & McKenzie SCP
Counsel to the Alliance

Annex
ANNEX

INTERNATIONAL ALLIANCE FOR PRINCIPLED TAXATION

COMMENTS ON 16 DECEMBER 2014 DISCUSSION DRAFT ON BEPS ACTION 10: TRANSFER PRICING ASPECTS OF CROSS BORDER COMMODITY TRANSACTIONS

6 FEBRUARY 2015
IAPT Comments on the 16 December 2014 Discussion Draft on BEPS Action 10, Transfer Pricing Aspects of Cross-border Commodity Transactions

1. We are pleased to provide hereafter our comments on the 16 December 2014 Discussion Draft on BEPS Action 10, Transfer Pricing Aspects of Cross-border Commodity Transactions (hereafter “the Draft”).

2. The IAPT welcomes and generally supports the Draft. We understand the need for commodity-dependent developing economies to enhance their transfer pricing enforcement capabilities and protect their tax base against abusive transactions. While our comments below may be technical in nature, they are accompanied by some practical and important business considerations which we hope will contribute to improving the proposed framework.

I. Introduction

3. Commodity transactions receive specific attention due to their significance to some developing and emerging economies. We believe that the proposed policy objective can generally be achieved through a sound application of the arm’s length principle taking into account in particular the five comparability factors and solid transfer pricing documentation requirements. For instance, we think that the problems listed at paragraph 2 of the Draft in relation to “the charging of significant fees to the taxpayer in the commodity producing country” and “the involvement in the supply chain of entities with apparently limited functionality” should be capable of being addressed through contemporaneous transfer pricing analysis and related documentation. The significant commercial differences amongst different resource commodities can be most effectively dealt with through such an approach.

4. We especially welcome the statements at paragraph 3 of the Draft that

The proposals described below aim at providing a consistent set of rules within the arm’s length principle to determine the arm’s length price for commodity transactions, which not only reduces the opportunities for BEPS, but also minimizes the instances where double taxation may occur.

and at paragraph 7 that

Implementation of any [measures] demands that tax administrations have knowledge of how the commodity markets operate and how commodity businesses contribute to value at various stages in the value chain. The development and implementation of transfer pricing rules which do not take into account the economic context, industry and business model in which associated enterprises operate and transact with one another may lead to arbitrary and unrealistic results and with that may lead to double taxation or double non-taxation hindering cross-border trade and investment.
5. We therefore suggest that the above statements be incorporated in the Transfer Pricing Guidelines themselves rather than left in the introductory section of the Draft.

6. We further suggest that the relevance to commodity transactions of the general transfer pricing analytical framework of Chapters I-III (in particular, the typical process described at paragraph 3.4, the guidance on the selection of the most appropriate method at paragraphs 2.1-2.11 and the general guidance on the CUP method at paragraphs 2.12-2.16) be reaffirmed.

7. We believe that the difficulties encountered by some commodity-dependent developing economies probably have more to do with their administrative resources than with the arm’s length principle itself. This should be recognized. We strongly support the OECD and other international organisations encouraging the enhancement by developing economies of their administrative capabilities through appropriate technical assistance programmes and other initiatives.

8. On the other hand, if the OECD wishes to introduce in the TPG exceptions to the arm’s length principle to address such administrative capability issues, it should make it clear what the nature and origin of the issue is, and ensure that such an exception is a well targeted measure which does not extend beyond the clearly delineated abusive situations it is designed for. The OECD should avoid giving the wrong impression that the issue arises because the arm’s length principle would not be sound in theory or not workable in practice. We read the deemed pricing method in Section II. B) as providing exceptions to the arm’s length principle, either to deal with lack of documentation, or to allow tax authorities to disregard contractual terms in case they are inconsistent with economic reality. Including in the TPG divergences from the arm’s length principle, even where motivated by sound policy objectives, should be handled with great care and remain clearly exceptional in order for the TPG to remain a body of principled guidance.

9. Paragraph 7 further indicates that

[...] research will be undertaken as part of the Tax and Development Programme to identify common adjustments to quoted prices to account for physical and functional differences in the controlled transaction and with that supplement the BEPS work with practical tools to help developing economies make maximum use of quoted prices for commodities. The research will focus on mineral commodities when they are traded as ores or in intermediate forms, initially covering iron ore, copper and gold.

10. We concur with the statement at paragraph 7 that industry knowledge is critical to the development and implementation of transfer pricing rules which are designed to single out a particular industry. For instance, the processes and final products for iron ore, copper and gold are very different. The mechanics of various quotations also differ, with some reflecting regulated prices, while others reflect actual prices observed in free market transactions, and some others prices which are voluntarily disclosed by trading entities rather than observed by an independent body. As further explained in our paragraph 16 below, even “common adjustments” by their nature may significantly differ in quantum from year to year depending on, for example, market conditions or intermediate product differences. The objective of putting together “common adjustments to quoted prices to account for physical and
functional differences” should be undertaken in consultation with industry and take into account commodity and quotation differences.

II. Proposed additions to Chapter II of the Transfer Pricing Guidelines

A) The use of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method

11. We welcome the clarification in Section II.A) of the Draft of the appropriateness of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method.

12. We agree with the statements at paragraph 8 that the CUP method would generally be the most appropriate transfer pricing method for commodity transactions and that, under the CUP method, the arm’s length price for the controlled commodity transaction can be determined, not only by reference to comparable uncontrolled transactions, but also by reference to a quoted price. We also agree with the statement at paragraph 9 of the Draft that where transactions involve the sale or purchase of commodities with a quoted price, such quoted price will generally provide evidence (taking into account any comparability adjustments needed) of an arm’s length price.

13. Paragraph 2.3 of the current Transfer Pricing Guidelines states that “where, taking account of the criteria described at paragraph 2.2, the comparable uncontrolled price method (CUP) and another transfer pricing method can be applied in an equally reliable manner, the CUP method is to be preferred.” Accordingly, and in line with paragraphs 8-9 of the Draft, we think that the proposed new guidance to be inserted after existing paragraph 2.16 of the Transfer Pricing Guidelines should be slightly revised as follows:

1. The CUP method will generally be the most appropriate transfer pricing method for establishing the arm’s length price for the transfer between associated enterprises of commodities for which a quoted or public price is available (“quoted price”), subject to the conditions of the controlled transaction and the conditions of the quoted prices being comparable. The reference to “commodities” shall be understood to encompass physical products for which a quoted price is used by independent parties in the industry to set prices in uncontrolled transactions.

14. To be consistent with the definition of the CUP method at paragraph 2.13 of the existing Transfer Pricing Guidelines, we suggest that the following paragraph be slightly edited as follows:

2. Under the CUP method, the arm’s length price for commodity transactions is determined by reference to prices observed in comparable uncontrolled transactions, and by reference to comparable uncontrolled arrangements represented by. The quoted prices of the commodity in the relevant period obtained in an international or domestic commodity exchange market provide evidence of prices agreed in uncontrolled transactions. [...]
always the case that all commodities are listed every day. It is sometimes necessary to use quoted prices of similar although not identical products and/or close although not identical dates as references to derive, through the performance of comparability adjustments, a range of arm’s length prices for a given controlled transaction. Furthermore, we think that the Draft should recognize that a variety of quotations can exist for a given commodity. This is because many commodities are listed on more than one market. We think that the Draft should endorse the use of arm’s length ranges for commodities as for other types of transactions.

16. On the other hand, it is critical to recognize that there are many stages towards achieving the end result of the final marketable commodity and related party transactions can take place at any stage, including intermediate stages prior to the commodity being processed or refined to achieve its final marketable form. It is this final marketable form that is relevant when one refers to a “quoted price”. For example, gold ore after a certain level of processing reaches the intermediate form of doré which, given the remaining non-gold contained therein, precedes its marketable form of gold bullion of a defined level of purity. The example of copper is conceptually similar. An intermediate form of copper can come in the form of copper concentrate which requires further refining to reach the marketable product of copper cathode. It is very important to note that no two intermediate stage commodities are identical (e.g. other mineral content) and, therefore, this can significantly influence the nature of the processes undertaken to reach marketable purity and their related costs.

17. We suggest that it should be made clearer that the Draft’s focus on the quoted market price of the finished products generally does not assist in arm’s length pricing at intermediate stages (unless they are traded commodities themselves, or in those cases where an intermediate product can be reliably priced by adjusting the price of a commodity, taking into account the functional analysis of the remaining transformation stage, which is not always the case).

18. Accordingly we suggest the following edits to paragraph 3 of the proposed addition to the Transfer Pricing Guidelines:

3. For the CUP method to be reliably applied to commodity transactions, the commodity being transferred in the controlled transaction and the commodity in the uncontrolled transactions or in the comparable uncontrolled arrangements represented by the quoted price need to be similar comparable, in terms of the physical features and quality of the commodity. In addition, the contractual terms of the controlled transaction should also be considered, such as volumes traded and the timing and terms of delivery. If the quoted price is used as a reference for determining the arm’s length price or price range, the standardised contracts which stipulate specifications on the basis of which commodities are traded in the market and which result in a quoted price for the commodity may be relevant. Where there are differences between the conditions of the controlled transaction and the conditions determining the quoted price for the commodity that materially affect the price of the commodity transactions being examined, reasonably accurate adjustments should be made to ensure that the economically relevant characteristics of the transactions are sufficiently similar comparable. Such differences can be related, for instance, to different specificities of the commodity (e.g. premiums for quality or availability of the commodity), different processing functions performed or required, or additional costs
incurred for transportation, insurance or foreign currency terms. In some cases where quoted prices are only available for similar although not identical commodities and/or dates, extrapolations may be needed to derive an arm’s length range of prices for the taxpayer’s controlled transactions. However, there are many stages towards achieving the end result of the final marketable commodity and related party transactions can take place at any stage, and the quoted market price of the finished products often will not assist in arm’s length pricing at intermediate stages. The pricing of intermediate stage products will depend on, among other things, functions performed. Consideration should also be paid to how unrelated parties use the quoted price as a reference price and make adjustments to reflect the position in the supply chain of the parties to the transaction.

B) Deemed pricing date for commodity transactions

19. We note that the proposal for a deemed pricing date for commodity transactions echoes the unilateral measures adopted by some countries for pricing commodity transactions, especially the so-called “sixth method” in the Latin American region. We strongly support the OECD efforts to deal with this issue on a multilateral scale and to seek consensus on a common approach, which we find far preferable to a series of unilateral measures implemented by individual countries. Furthermore, we support the OECD’s efforts to develop such rule within the arm’s length principle and existing CUP method.

20. That being said, any deemed pricing method relies on an arbitrary assumption with respect to one important comparability factor, which is why it diverges from the arm’s length principle. We read the proposal concerning a deemed date for commodity transactions as providing exceptions to the arm’s length principle, either to deal with lack of documentation, or to allow tax authorities to disregard contractual terms in case where such contractual terms are inconsistent with economic reality, thus aiming at protecting countries against taxpayers’ manipulations of pricing dates for tax avoidance purposes. Including in the TPG divergences from the arm’s length principle, even where motivated by sound policy objectives, should be handled with great care and remain clearly exceptional in order not to weaken the arm’s length principle and relevance of the TPG as a broad consensus instrument. In our view it should be made clearer in the proposed addition to the TPG that this is an exceptional measure whose application is intended to be restricted to clearly identified situations, with the objective of counteracting abusive transactions consisting in manipulating the pricing date of commodity transactions.

21. Accordingly, we believe that it is critical to further define the thresholds for this measure to apply and the consequences of its application. The wording in paragraph 5 of the proposed addition to the Transfer Pricing Guidelines refers to two substantially different situations where a deemed date could apply instead of the taxpayer’s pricing date, with each of these two situations entailing differing consequences as to the determination of the deemed pricing date.

22. The first situation refers to cases where the taxpayer could not provide reliable evidence of the actual pricing date agreed by the associated enterprises in the controlled commodity transaction. The proposed guidance suggests that, lacking such evidence, “tax administrations may deem the pricing date for the commodity transaction to be the date of shipment as evidenced by the bill of lading or equivalent document depending on the means of transport.”
23. We read this situation as an administrative mechanism to deal with lack of documentation and asymmetry of information, which we find reasonable. We believe that contemporaneous transfer pricing documentation should be regarded as reliable evidence of the actual pricing date. Furthermore, our members note that meticulous documentation often needs to be prepared for non-tax purposes, e.g. for customs or regulatory purposes, which we think should be considered reliable evidence for transfer pricing purposes. Related party contracts should not be dismissed as reliable evidence of the actual pricing date just because they were concluded between related parties.

24. The proposed addition to the TPG at paragraph 5 includes the following text:

5. […] In the absence of reliable evidence of the actual pricing date agreed by the associated enterprises, tax administrations may deem the pricing date for the commodity transaction to be the date of shipment as evidenced by the bill of lading or equivalent document depending on the means of transport. This would mean that the price for the commodities being transacted would be determined by reference to the quoted price on the shipment date, subject to any appropriate comparability adjustments.

25. We think that the guidance should further clarify that the imputed shipment date should be the date of shipment of the commodity at the same stage of transformation, and is not intended to apply to products at intermediate stages, as a deemed pricing date would not help with the latter: pricing an intermediate stage product based on the quoted price of the finished product at the shipment date of the intermediate product would generally not make sense. For example, further to our comments in paragraph 16 above, in the case of gold doré it may take a period of, say, several weeks to refine doré to bullion form. As a result, using the prevailing quoted price on the date of shipment of gold doré may not be appropriate. Copper is similar in that the final pricing may be determined months after the date of shipment of copper concentrate. In addition, the use of the quoted price at the date of shipment for an intermediate stage product may not take into account risks such as capacity and credit risks with respect to refineries, quantity risk for refined commodity content, and market price risk. We would welcome examples illustrating the performance of appropriate comparability adjustments in the context of the deemed pricing method.

26. The second situation refers to cases where “the pricing date actually agreed by the associated enterprises is consistent with other facts of the case.” The proposed guidance suggests that in such cases, the tax administrations “may impute an actual pricing date consistent with the evidence provided by those other facts of the case (taking into consideration industry practices)”.

27. This second situation is very different from the first one, in that it is not addressing a mere documentation or information asymmetry issue. Rather, it is opening the possibility for tax administrations to disregard the contractual terms of the controlled transaction and substitute for it other terms which would be more “consistent with the facts of the case”, irrespective of the existence of contemporaneous transfer pricing documentation or other evidence of the date agreed between the parties.

28. We believe that situations where contractual terms would be disregarded should remain exceptional and appropriately targeted, and therefore urge the OECD to provide further clarification as to (i) what evidence would lead to characterising an inconsistency between the agreed date and the facts of
the case and (ii) how to determine an “actual pricing date consistent with the evidence provided by those other facts of the case” to be substituted for the taxpayer’s contractual pricing date.

29. It is unclear to us what facts will be regarded as relevant to appreciate consistency of a pricing date. For instance, the proposal should not allow tax authorities to disregard the agreed date just because the shipment date differs from the agreed date, or because an offshore trading company is involved in the transaction. The guidance should clarify that this criterion should be examined by reference to the facts and circumstances of the particular controlled transaction.

30. The possible substitution of a deemed date for the pricing date used by the taxpayer can have significant tax consequences, including double taxation issues to be dealt with in mutual agreement procedures. A reasonable and understandable threshold should therefore be determined for each of the two above criteria in order for the proposal to be appropriately targeted, effective in achieving its deterrent purpose, and to avoid creating detrimental and unnecessary uncertainty.

C) Potential additional guidance on comparability adjustments to the quoted price

31. We agree with the statement at paragraph 16 that

Where pricing of commodities is based on adjustments or differentials from a quoted price, it is understood that those adjustments or differentials may take into account physical differences in the product, different specifications required, freight, any further processing costs, and other features of the particular transaction. In some cases these adjustments or differentials are themselves based on information and costings which are transparent or standard in the industry.

32. Generally, we think that this paragraph should be included in the TPG themselves. However, it may not be necessarily the case that “information and costings” are “transparent or standard in the industry” to, for instance, permit a readily available standardized source of reference for tax administrations to determine the pricing of related party adjustments under the arm’s length principle. For example, refining charges depend on market conditions and particular terms and conditions of the refining arrangement. Refining charges may take the form of a monetary charge per unit of the refined commodity or a percentage take of the refined commodity content. Moreover, there may be additional charges dependent on other minerals contained in the intermediate stage product that need to be processed at the refining stage. It is for such reasons that we stress in our paragraph 3 that the proposed policy objective can generally be achieved through a sound application of the arm’s length principle and a contemporaneous transfer pricing analysis.

Conclusion

33. The IAPT thanks the OECD for this opportunity to comment and expresses interest in further consultation on issues related to this proposal. In particular, we would welcome the possibility to speak at the public consultation. Our members who have knowledge of and experience in the resource industry may be able to participate in this process if requested.
Mexico City, February 6, 2015

Via e-mail
transferpricing@oecd.org
Mr. Andrew Hickman
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration

Dear Mr. Hickman,


1) Comments to section A) of the Draft

The use of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method

Section A) of the Draft provides a proposal of clarifying the guidance in the existing Transfer Pricing Guidelines, stating that the CUP method would generally be the most appropriate transfer pricing method for commodity transactions and that under the CUP method, the arm’s length price for the controlled commodity transaction can be determined, not only by reference to comparable uncontrolled transactions, but also by reference to a quoted price.

As established in the Draft, where a quoted price is available for a commodity, and the terms and conditions of that comparable uncontrolled transaction are comparable to those of the controlled transaction, the quoted price may provide reliable information for applying the CUP. Where there are differences that have a material effect between the terms and conditions of the controlled transaction and the uncontrolled transaction represented by the quoted price, further analysis should be performed before concluding that the CUP should be the most appropriate method.

In this regard, it is understood that the Draft establishes that when applying the CUP method in commodity transactions by considering a quoted price, a functional analysis should be carried out in order to identify the functions, risks and assets incurred by each party in the controlled transactions so as to identify the
substance of the transaction, and determine if the transactions from which the quoted price are obtained are considered comparable from a transfer pricing standpoint. In case such transactions are not comparable, any comparability adjustments should be carried out, or furthermore, other method could be applied.

Notwithstanding the aforementioned, it is reasonable to consider that there are intra-group transactions that independent enterprises may not carry out, which is also applicable for commodity transactions.

In relation with the abovementioned, paragraph 1.11 of the OECD Transfer Pricing Guidelines establishes the following:

1.11 A practical difficulty in applying the arm’s length principle is that associated enterprises may engage in transactions that independent enterprises would not undertake. Such transactions may not necessarily be motivated by tax avoidance but may occur because in transacting business with each other, members of an MNE group face different commercial circumstances than would independent enterprises. Where independent enterprises seldom undertake transactions of the type entered into by associated enterprises, the arm’s length principle is difficult to apply because there is little or no direct evidence of what conditions would have been established by independent enterprises. The mere fact that a transaction may not be found between independent parties does not of itself mean that it is not arm’s length.

Considering that there could be intra-group commodity transactions that independent enterprises may not carry out, in some cases the CUP method would not be applicable for pricing commodity controlled transactions, or would represent high difficulties, even if reasonable adjustments are applied to the quoted price.

We suggest to clearly establish in the document that the tax administrations must consider that there are intra-group transactions that independent enterprises may not carry out, or there is not public information available, which is also applicable for commodity transactions resulting in the difficulty of applying the CUP method.

In addition, considering that in such cases the CUP method may not be applicable, the document should also include the possibility for applying other transfer pricing methods for pricing commodity transactions.
2) Comments to section B) of the Draft

_Deemed pricing date for commodity transactions_

The Draft includes that one of the challenges faced by tax administrations is the ability to verify the pricing date in commodity transactions, proposing guidance deeming the pricing date to be the quoted price, incorporating any comparability adjustments, on the shipment date as evidenced by the bill of lading or equivalent documents. This would mean that the price for the commodities being transacted would be determined by reference to the quoted price on the shipment date, subject to any appropriate comparability adjustments.

It is important to mention that in commodity transactions, either controlled or uncontrolled, there is a difference in timing between the date when entering into an agreement and shipment dates, thus, considering the proposal for pricing commodities being transacted by reference to the quoted price on the shipment date would not be reasonable. Additionally, adjusting the differences between the quoted price on the transaction date and the shipment date may result in high difficulties for the taxpayer.

In this regard, we suggest OECD reviewing this guidance of considering that the price for the commodities being transacted would be determined by reference to the quoted price on the shipment date.

* * *

The participation of IFA Grupo Mexicano, A.C. is made on its own behalf exclusively as an IFA Branch, and in no case in the name or on behalf of Central IFA or IFA as a whole.

We hope you find these comments interesting and useful. We remain yours for any questions or comments you may have.

Sincerely,

IFA Grupo Mexicano, A.C.
Mr. Andrew Hickman
Head of Transfer Pricing Unit,
OECD Centre for Tax Policy and Administration
2, rue André Pascal
75775 Paris

Submitted by Email to transferpricing@oecd.org

6 February 2015

Dear Mr. Hickman

Submission in response to OECD Proposed Modifications to Chapter II of the Transfer Pricing Guidelines Relating to Cross-Border Commodity Transactions

Please find enclosed our submission in response to the Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions that was released on 16 December 2014.

The types of transactions covered by the Discussion Draft are specific in nature, relative to other intercompany transactions addressed in the context of BEPS. The impact of these proposed changes will affect Irish business with international operations. On behalf of our members, we submit comments in an effort to help ensure the benefits of the Discussion Draft can be achieved without undue burden on taxpayers to comply and document the measures.

We would like to thank Warren Novis and the Transfer Pricing team from KPMG Ireland for their assistance in preparing our submission and gathering input from members in the Irish Tax Institute.

We are available for further discussion on any of the matters raised in our submission.

Yours truly,

Andrew Gallagher
President
Irish Tax Institute
Irish Tax Institute

Response to OECD Discussion Draft: Transfer Pricing Aspects of Cross-Border Commodity Transactions

February 2015
About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland’s AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.
The Irish Tax Institute is writing in response to the Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions, which the OECD released on 16 December 2014. We prepared this submission with consideration and input from a number of our members.

1. Commodities are not different

In general, the OECD’s 2010 Transfer Pricing Guidelines for Multinational Enterprises (“the Guidelines”) do not define rules covering the trade in one type of good over another. The arm’s length principle should continue to be guided by how independent parties would engage in the same transaction. From the work undertaken in Action 1 of the BEPS project, it was decided not to distinguish taxation of the digital economy apart from other business.

We recognise for commodity transactions, there exists substantial external data on how arm’s length parties might negotiate their terms; yet, quoted prices are not always a reference for third party negotiations. Paragraphs 2.14 of the OECD Guidelines recognise that the CUP method is preferable over another method if the CUP can be reliably applied. Overall, we believe the existing narrative on the CUP method in the OECD Guidelines addresses the issue. It would be useful to understand why the existing language in the OECD Guidelines are not sufficient to deal with commodity transactions.

2. Sixth method

The Discussion Draft introduction makes reference to tax authorities in some countries having adopted to apply a sixth transfer pricing method; that is, not one of the five prescribed OECD methods. We concur that clearer guidance is helpful to limit the use of transfer pricing approaches that are inconsistent with arm’s length pricing or the OECD prescribed methods. To address the BEPS issues faced with commodity transactions, it would be helpful to have a better understanding of this ‘sixth method’ and the circumstances in which it has been applied.

The Discussion Draft does not indicate whether the ‘Sixth Method’ would continue to be applied by countries in Latin America if the proposed guidance is formally introduced. It is important that BEPS recommendations recognise the potential for countries to choose not to adopt them. As such, clarity would be useful as to how taxpayers deal with disputes between the OECD proposed pricing guidance on commodities and the pricing approaches mandated in countries where the OECD guidance is not accepted.

3. Disproportionate preference for the CUP method

The Discussion Draft states that the CUP method would generally be the most appropriate transfer pricing method for commodities and the arm’s length price can be determined by reference to quoted prices or preferably to known comparable transactions with unrelated parties. The proposed new text in paragraph 12 will be inserted into the Guidelines related to the CUP, which currently does not specify the types of transactions where the CUP method is most applicable. For example, the CUP method is most frequently used to price interest rates on intercompany debt, but no such guidance is included in the Guidelines. The specific inclusion of commodities in the CUP method departs from intention of the OECD Guidelines to be broadly applicable.

Undue preference toward the CUP method and quoted prices can divert the transfer pricing analysis from a proper comparison of functions, risks and assets used in the context of the commodity transaction. The Discussion Draft should emphasise the standard comparability of functions, risks and assets, beyond the physical features and quality of the commodity itself.

Substantial consideration should be given to the management and allocation of risk to the relevant transactions. For commodities, the hedging to commodity prices is significant to selecting the most appropriate method. Given the volatility of commodity prices, multinationals may seek to manage risk through financial derivative contracts. This is a key part of the overall value chain and requires
consideration.

Material differences in functions, risks or assets can easily make the CUP method not appropriate and another method most appropriate. It is helpful that the proposed wording in paragraph 12 is not a requirement to use the CUP method but rather recognition that it “can be appropriate”.

Profit-based methods should be considered more reliable than the CUP if the combination of functions, risks and assets indicates they can be applied more reliably. It can be the case that the entity purchasing commodity goods may be indifferent to the price if it is guaranteed a return for its selling and distribution functions.

We acknowledge that prices quoted on a recognised exchange may not meet the definition of a comparable uncontrolled transaction in its strictest sense, given differences in comparability that cannot be adjusted for. Paragraphs 2.18 to 2.20 of the Guidelines provide examples applying the CUP method and Chapter III of the Guidelines recognises the importance of performing comparability adjustments, where appropriate. It may be useful to provide an example in this section for commodities and the potential use of quoted prices. Consideration should be given to allow for market practices that do not set prices on quoted commodity rates. In many illiquid commodity markets, a recognised market price may not be the starting point for negotiations between independent parties.

4. Deemed pricing date

Section B of the Discussion Draft introduces a “deemed pricing date” for commodity transactions in the absence of reliable evidence of the pricing date actually agreed by the parties to the controlled commodity transaction. The term “pricing date” refers to the specific date or time period selected by the parties to determine the price for the commodity transactions. The Discussion Draft deems the pricing date to be the quoted price, with comparability adjustments, on the shipment date evidenced by the bill of lading or equivalent documents.

Our comments in response to this new guidance are as follows:

a) Reliable evidence – We request that the OECD provide substantial clarity on what should satisfy the requirement to provide “reliable evidence”. It would be helpful to provide specific examples on what transpires between independent parties, recognising established market practices that may apply to certain sectors. We submit that if a taxpayer has applied standard commercial terms and conditions to its intra-group commodity trade as part of a documented agreement, then a ‘deemed pricing date’ should not override a valid agreement that adheres to the arm’s length principle.

The proposed wording in the Discussion Draft may be reasonable if no documentation or other evidence exists on the pricing date of the intercompany transaction.

b) Long-term arrangements – It makes sense to set prices for individual intra-group transactions to publicly quoted prices, with appropriate adjustments. However, consideration should be made to allow for intra-group agreements that price commodity trades over long-term commercial arrangements. If such long-term arrangements are entered into by the parties and the terms can be demonstrated to be arm’s length at the time the arrangement was agreed, then the ‘deemed pricing date’ method should not set aside the long-term arrangement.

c) Burden on information systems

The proposed wording could potentially lead tax authorities to question taxpayers’ evidence of their commodity pricing, and demand hypothetical prices linked to the proposed ‘deemed pricing date’ method. Multinationals employ varying degrees of sophistication in their enterprise-wide information systems. Larger enterprises can normally afford and will pay for more complex information systems to address operational needs. It will likely be very challenging and costly for all business to re-price a large quantum of commodity transactions based on the shipment date, if so requested by a tax authority.
The proposed new guidance could place unreasonable information systems and administrative burden on business. Considering the following requirements on an information system to produce prices on a ‘deemed pricing date’ method:

1. Track individual intercompany trades of a commodity, and its shipment date, to the time the commodity is consumed and recognised as a cost of revenue.
2. Contain all relevant data on the transaction, e.g. volume, quality, etc. in order to apply comparability adjustments from the quoted commodity price.
3. Allow for retro-active changes to price in order to generate the hypothetical price using the quoted price on the relevant shipment dates and apply pertinent comparability adjustments.

In particular, transaction volumes will readily differ in the business. It would be a substantial burden to track and then adjust for each volume difference when a business may carry out a high number of discrete commodity transactions. We request the OECD advocate limited use and prohibit the requirement to produce ‘deemed pricing date’ information given there will be a disproportionate burden on multinationals.
Mr. Andrew Hickman,
Head of Transfer Pricing Unit,
Centre for Tax Policy and Administration
Organisation for Economic Cooperation and Development

Accounting & Tax Committee
Japan Foreign Trade Council, Inc.

Comments on the Discussion Draft on
Action 10 (the transfer pricing aspects of cross-border commodity transactions)
of the BEPS Action Plan

The following are the comments of the Accounting & Tax Committee of the Japan Foreign Trade Council, Inc. (JFTC) in response to the invitation to public comments by the OECD regarding the “BEPS Action 10: Discussion Draft on the transfer pricing aspects of cross-border commodity transactions” released on December 16, 2014.

The JFTC is a trade-industry association with Japanese trading companies and trading organizations as its core members. One of the main activities of JFTCs Accounting & Tax Committee is to submit specific policy proposals and requests concerning tax matters. Member companies of the JFTC Accounting & Tax Committee are listed at the end of this document.

General Comments

1. We support the OECD’s work with regard to clarifying the use of the CUP method as a transfer pricing method with regard to transactions in commodities listed on commodity exchanges.

2. Nevertheless, given that the scope of application of the CUP method proposed by the OECD has not been defined clearly, it is hoped that, in order to enhance predictability for taxpayers, the scope of application is clarified. When that is done, we hope that the scope will be limited to transactions between manufacturers and distributors, namely transactions for primary products.
3. In this discussion draft, the CUP—for which the starting point is the existence of publicly available prices or deemed prices relating to commodity transactions—is adopted as the default method. However, the use of that method should be premised on there being no difference, for example physical differences in the commodities and related costs, between comparable transactions and transactions between associated enterprises, provided that if such differences do exist, reasonably accurate adjustments may be made to eliminate the impact thereof, and if such adjustments are not possible, the use of this method is not appropriate.

4. In addition, when using deemed prices, their use should be premised upon full confirmation that it is appropriate to use them in the same way as quoted prices. We request that additional text be added to the effect that if, in spite of the fact taxpayers give full explanations concerning price-setting for commodity transactions, tax administrations do not take those explanations into account and use deemed prices, it shall be necessary for those tax administrations to give a full explanation with regard to the appropriateness of their use of the relevant deemed prices.

Specific Comments

II. Proposed additions to Chapter II of the Transfer Pricing Guidelines
A) The use of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method

Paragraph 12

- With regard to paragraph 4 of the proposed text for addition to the Transfer Pricing Guidelines, we agree with the point that the price-setting policy for commodity transactions should be included in transfer pricing documentation. However, tax administrations should respect the content of the transfer pricing documentation, and if they reach conclusions that differ from that content, the burden of proof therefor should rest with those administrations.

- In order to enhance predictability for taxpayers, active steps should be taken to issue guidelines with regard to “commodity,” “commodity exchange market,”
and “recognized and transparent reporting or statistical agencies,” and should include a list of examples. In addition, in order to avoid unnecessary disputes, tax administrations should mutually respect other countries' lists.

C) Potential additional guidance on comparability adjustments to the quoted price

**Paragraph 16**

- The “quoted price” is not an absolute index for individual transactions. In view of this, in order to take into account features that are unique to each particular transaction, for example physical differences in the commodities involved and related costs (insurance, transportation and other logistics costs, etc.), as mentioned in the proposal, we would like to see the Guidelines include wording to the effect that certain adjustments to the quoted price are considered appropriate.

- If the above-mentioned related costs cannot be established at the time a transaction is made, in some cases price-setting and adjustment is conducted in advance on the basis of estimated costs in accordance with contractual agreement between the parties. Such costs should also be accepted as a basis for determining arm's length prices, as long as that determination is on the basis of rational assumption and computation.

- In order to address such a situation, it may be advisable to introduce a system (safe harbor rule) under which a transaction price is deemed to be the arm's length price if the differential between the transaction price and quoted price after adjustment for differences is within a certain range. If all states were to commit to introduce such a system jointly, it may make it possible to achieve rational price-setting that is not dependent on particular tax administrations' subjectivity or discretion, and to reduce the administrative burden on both tax administrations and taxpayers.
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Comments on the Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions

Professionals in the Global Transfer Pricing Services practice of KPMG welcome the opportunity to comment on the OECD’s discussion draft titled “BEPS ACTION 10: Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions” (“Discussion Draft”). This paper comments on the transfer pricing issues in relation to commodity transactions that may lead to base erosion and profit shifting (“BEPS”). Below KPMG provides some general comments on the Discussion Draft and our remaining comments focus on the following three key areas raised in the Discussion Draft:

A. The use of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method;
B. Deemed pricing date for commodity transactions; and
C. Potential additional guidance on comparability adjustments to the quoted price.

General Comments

KPMG’s general comments on the Discussion Draft are as follows:

1. The Discussion Draft includes broadly reasonable guidance regarding the application of a comparable uncontrolled price (“CUP”) method where appropriate, subject to our comments below.

2. The Discussion Draft has a strong theme of anti-avoidance in the language and proposals, without presenting clear evidence that this is either appropriate or necessary. The drafting implies that commodity transactions deserve to be an exception from the general guidance on application of the arm’s length principle, but it is not clear to KPMG that this is required.

3. The key difference for the commodities sector as identified by the Discussion Draft is the existence of additional forms of external CUP data, in the form of price indices and exchange-quoted pricing for certain commodity transactions. Where appropriate, and where the standards...
of comparability are met, KPMG agrees this data could form the basis of a transfer pricing analysis for commodity transactions.

4. In our view, however, there are situations where use of this CUP data would not be appropriate, or indeed arm’s length, and guidance encouraging its use even in these situations would be inappropriate. KPMG discusses this in more detail, including specific examples, in Section A below.

5. Thus, while in our view there are many situations for commodity transactions where a CUP method using exchange quoted pricing is reasonable, KPMG strongly encourages the OECD to consider softening the current language and direction of the Discussion Draft. In particular, the OECD should remove any guidance that allows tax authorities to either:

   a) Re-characterize an intra-group commodity transaction structure that is also used at arm’s length into something for which an exchange-quoted CUP can be applied; or

   b) Shortcut a full transfer pricing analysis and thorough assessment of the most appropriate method.

6. In addition, the Discussion Draft does not address the fact that in some countries, certain specific commodities (especially those that tend to be important local resources) are priced by domestic law. Thus, multinational enterprises (“MNEs”) could still face certain issues where the guidance in the Discussion Draft leads to transfer prices that are inconsistent with the price mandated by local laws. Under such circumstances, transfer pricing adjustments that are inconsistent with local law are not appropriate.

A. The use of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method

The OECD proposes that the CUP would generally be the most appropriate transfer pricing method. The existing OECD Transfer Pricing Guidelines acknowledge that CUP has been found to work effectively in many cases involving the purchase and sale of commodities. Furthermore, the Discussion Draft proposes that quoted or publicly available prices should be used under the CUP method as a reference to determine an arm’s length price for controlled commodity transactions. Quoted prices for commodities can be obtained from international or commodity exchange markets. Quoted prices can also be obtained from recognized price-reporting agencies or from governmental price-setting agencies.

Given the above, KPMG has the following comments with regards to the use of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method:
1) As above, KPMG agrees that exchange-quoted pricing provides useful comparable data for certain transactions, in particular, where exchange-quoted prices are available which match the terms and conditions of the related-party transaction. In general, exchanges report market pricing for spot purchases of commodity product as well as certain related markets with sufficient liquidity (futures contracts, forwards, etc).

2) Exchanges generally quote prices for spot transactions. However, companies may enter into agreements that fix prices for a specified period of time. Spot prices are generally not appropriate comparables for prices set under long term arrangements.

3) The commodity sector, however, involves various complex inter-company structures and value chains. MNEs which trade commodities have many varying business models depending on the strategy they choose to adopt and the market segment to which they belong (e.g., energy, power, metals, agriculture etc). Any general rule, such as the CUP method would “generally be the most appropriate transfer pricing method”, precludes an appropriate level of review of the specific facts regarding the transaction before selecting the most appropriate method. For some markets and trading strategies, third parties do not set pricing based on current quoted exchange prices in the spot market – and the requirement to use quoted exchange prices should not be imposed on taxpayers in an intra-group context.

4) Examples of scenarios where an exchange-quoted price is difficult to apply include the following:

   a) A commodity trading company may provide other forms of economic support to the independent producer, such as pre-financing for an independent crop grower or other financial or technical support. Pricing for these third-party transactions is not set with reference to quoted exchange at the point of sale (but rather on a negotiated position at an earlier date).

   b) Commodity trading companies may not be vertically integrated (and therefore do not own local assets), but they do procure locally from independent producers (e.g. farmers). These local procurement functions often negotiate pricing for deals in advance of acquiring the product. In some situations, that procurement company has acted on the advice of a trading/marketing company in another location (an entity which has the skills and the relationships to match the purchase to a willing buyer). It would not be arm’s length to enforce on that local procurement entity the transfer pricing requirement to sell its product with reference to quoted exchange prices at the date of sale.

   c) In some arm’s length scenarios, commodity producers agree contracts with purchasers which provide for volume commitments on one party or another. At one end of the spectrum, an example of these contracts is a “guaranteed offtake” agreement, which ensures a producer will sell 100% of its output to a single purchaser. Other supply contracts which use volume commitments fix a lower proportion of the producers output to a single purchaser. These contracts are agreed at arm’s length, as it gives
producers a way to manage key market risks of their business and provide certainty that they can cover their operating costs in a financial period. The pricing of these contracts may (or may not) be made with reference to exchange-quoted prices in the spot market at time of delivery, but even where they are there will typically be negotiated discounts applied to the pricing. Many factors influence the results of these negotiations, and it may (or may not) be possible to factor into a transfer pricing analysis reasonably reliable adjustments in order to select the CUP as the most appropriate method for these transactions.

d) Commodity transactions are continually affected by supply and demand. In theory, spot price differences between two locations (after taking into consider the transportation costs between the locations) will quickly disappear as traders try to take advantage of the arbitrage opportunity. However, there often are circumstances whereby the spot price differences remain due to other factors or economic inefficiencies. This can be seen in the crude oil market whereby transportation limitations (e.g., pipeline capacity constraints) may prevent the supplier from getting the product to the market where demand is higher. As a result, the price differential can only be exploited by the entity that has secured the transportation resources. Often it is the trader/marketer, and not the producer, that has secured this transportation. Therefore, the application of the CUP must consider these other factors. This is also an important consideration when applying a deeming provision as the deemed price may neglect to consider the reasons for the price differential.

5) As commodity prices can be volatile, hedging to manage risk is common in commodity markets. Such hedging provides different entities of the value chain with long-term certainty over pricing while shifting these risks to the hedging company. Therefore, the pricing can differ from the spot market prices observed on exchanges. Nevertheless, this pricing is an arm’s length arrangement that should be respected by tax authorities.

6) Commodity traders often use financial derivative contracts. This hedging is an important activity and is used to reduce the risk of adverse price movements in an asset. As market participants are involved in transactions that are taking place in the future and transactions that are affected by market volatility, hedging is a significant function in the value chain. Practical experience is that tax authorities in some tax jurisdictions disallow deductions for intra-group financial hedging transactions. This is an important parameter that was not mentioned in the Discussion Draft. In our view, it requires further consideration by the OECD, as a broader use of the CUP method for commodity transactions could be appropriate with an arm’s length hedging transaction in place with the MNE (albeit this would lead to an additional administrative burden on taxpayers from implementing an intra-group hedge).

7) The Discussion Draft does not appear to acknowledge circumstances whereby a CUP derived from quoted prices does not give an arm’s length answer. In particular the final sentence of Paragraph 12.4 of the Discussion Draft does not sufficiently indicate that the
position of parties in the supply chain and the functions and risks of the parties must be taken into account. As it stands, the paragraph lends support to potential audit outcomes that would not appropriately account for arm’s length profits legitimately earned by all parts of the supply chain, thus making dispute resolution based on this one-sided guidance very problematic.

B. Deemed pricing date for commodity transactions

The OECD proposes to introduce a “deemed pricing date” for commodity transactions in the absence of reliable evidence of the pricing date actually agreed by the associated enterprises in the controlled commodity transaction. The term “pricing date” refers to the specific date or time period selected (e.g., a specified range of dates over which an average price is determined) by the parties to determine the price for the commodity transactions.

Given the above, KPMG has the following comments with regards to the deemed pricing date for commodity transactions:

1) There is no need for the use of a “deemed pricing date” if the customary terms and conditions and specific timing of the intra-group transaction is clearly identified as part of the intercompany arrangement, and if the MNE follows the terms of that arrangement. KPMG believe that it is important that deemed pricing date should not be used to replace the actual date of the transaction when that date is clearly identified as this would not be consistent with the arm’s length principle. The current wording should be clarified to specify criteria that need be present for the deemed pricing date to not be imposed on the MNE. Otherwise, KPMG is concerned that tax authorities may take inconsistent positions as to what is “reliable evidence” and MNEs would be forced to work in an uncertain environment.

2) If, however, the MNE does not clearly identify the pricing date for the intra-group transactions or does not price based on this clearly identified date, per criteria that KPMG recommends above, KPMG believes that the proposed guidance regarding use of the deemed pricing date is reasonable.

3) The current Discussion Draft does not address long-term pricing for commodity transactions. Clearly for these type of arrangements the spot rate would not be appropriate and KPMG would recommend that the guidance recognize this important distinction. This issue may also be inter-related with the comment in Section A as long term contracts are relatively common in commodity transactions. As third parties will enter into these long-term transactions, it is important for the guidance to recognize that related parties should also be able to enter into similar arm’s length long-term pricing arrangements and not be forced to use the price on the deemed pricing date that likely fails to recognize these long term pricing arrangements.
C. Potential additional guidance on comparability adjustments to the quoted price

The OECD proposes that where pricing formulae rely on transparent or industry information, it would be helpful for tax administrations to be aware of such information when considering comparability adjustments.

Given the above, KPMG has the following comments with regards to comparability adjustments to the quoted price:

1) While the requested information would be helpful, it is important to recognize that there are potentially many different adjustments that may be relevant and these adjustments can vary across commodities and across geographies for many different reasons. For example, adjustments for the quality of crude oil are common, but the adjustment may vary over time due to the supply and demand for the different grades of crude oil that are available at a given time.

2) KPMG agrees that it would be useful for MNEs to provide information on these customary adjustments, but it is also important for tax authorities to realize that the application of these customary adjustments does not necessarily involve pre-defined calculations or formulae. Therefore, it is important that the adjustments to CUPs reflect the practices of the commodity traders involved in arm’s length transactions for the particular commodity for the particular market.

3) KPMG would welcome the opportunity to be involved in discussions on this matter if the OECD decides to continue to pursue this aspect of the guidance.

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About KPMG

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 155 countries and have more than 162,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.
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Rotterdam, 4 February 2015
TT/DVS/RA/MW

Comments on the Discussion Draft on Action 10 of the BEPS Action Plan on the Transfer Pricing Aspects of Cross-border Commodity Transactions

Dear Mr Hickman,
Dear Andrew,

Thank you very much for the opportunity to provide comments on the Discussion Draft on Action 10 of the BEPS Action Plan (the “Discussion Draft”) which was released by the OECD for public comments on 16 December 2014. Mazars Global Transfer Pricing and International Taxation professionals (“Mazars”) are impressed by all the progress that the OECD has made to date and we are very pleased to provide our input on the Discussion Draft.

We strongly support the OECD transfer pricing work being undertaken under BEPS Action 9 (on risk and capital), BEPS Action 10 (especially on recharacterisation and low value-adding services) and BEPS Action 13 (transfer pricing documentation and country-by-country reporting). We agree this work is relevant to commodity transactions and could help to ensure that transfer pricing outcomes in commodity transactions are in line with value creation.

Mazars Tax Policy team highly appreciates the OECD engagement with developing countries and welcomes the fact that developing countries and other non-OECD/non-G20 economies have been extensively consulted and their input has been considered by OECD. While we agree that BEPS is a global issue and thus requires a global solution, it is also very important to recognise that the risks faced by developing countries from BEPS, as well as the challenges in addressing them, may be different (both in scale and nature) to those faced by developed countries. Therefore, we share the concerns of the Working Group in connection with the problems and policy challenges in respect of commodity transactions faced by tax administrations of commodity-dependent developing countries.
Our specific comments on the Discussion Draft are provided below:

A. The use of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method

The Working Party No. 6 on the Taxation of Multinational Enterprises (“Working Party”) proposes to include additional guidance in Chapter II of the Transfer Pricing Guidelines to clarify that (i) the comparable uncontrolled price (“CUP”) method can be an appropriate transfer pricing method for commodity transactions between associated enterprises; and (ii) that quoted or publicly available prices can be used under the CUP method as a reference to determine the at arm’s length price for the controlled commodity transactions.

Mazars welcomes the additional guidance provided in the proposed amendments of the Transfer Pricing Guidelines. The inclusion of the CUP method as a possible “the most appropriate” transfer pricing method in commodity transactions between affiliated entities provides for additional certainty in selecting the appropriate transfer pricing method. Generally, the CUP method is the best method for pricing intercompany commodity transactions. We note, however, that the appropriateness of the CUP method (being dependent on the availability of comparable transactions) in a commodity transaction between affiliated entities is highly dependent on the way the supply chain is structured.

In straightforward structures with a supplying company and a (local) trading company that concludes contracts in its own name and for its own risk, the CUP method may be appropriate and relative easy. In integrated structures where the local entity serves as a ‘hub’ which concludes contracts in its own name and for its own risk, as well as performs support functions to the wider group, the CUP still may be the most appropriate. However, in such specific situations, it may be more difficult to find CUPs as the transactions need to be divided. Correctly identifying individual transactions when dividing and splitting services, may prove burdensome to make a good justification on the division/split implemented. Where some entities may enter into contracts in their own name and for their own risk, some entities in a structure may hardly run any risk. In this respect, we also refer to our comments on the Discussion Draft on Action 7 of the BEPS Action Plan on Preventing the Artificial Avoidance of the Permanent Establishment Status which was released by the OECD for public comments on 31 October 2014, in particular with respect to the a commissionaire arrangement. We note that some trading companies may even have set-up commissionaire structures and similar arrangements for genuine business reasons. By setting-up such a structure, companies could successfully have presence and profitable enterprises in multiple jurisdictions. We note that in such legitimate structures and/or agreements, double non-taxation may not be an issue, but tax rate arbitration could exist as an unintended effect. Therefore, when addressing this topic, we would recommend that not only the comments received in relation to the transfer pricing work undertaken under BEPS Actions 9, 10 and 13 should be considered, but also comments received on the Discussion Draft on Action 7. We would welcome a more holistic approach by linking the aforementioned documents, as well as a further explanation of the Working Group.
With regard to the proposed inclusion of the use of a quoted price under the CUP method, we note that a commodity market generally is highly standardized and uniform. Prices are typically volatile and future trends are difficult to predict. Given these circumstances, we are of the view that the inclusion of a wording to indicate that a quoted price can be used under the CUP method should merely be considered as an additional clarification as, in our experience, a quoted price is typically the pricing base used in intercompany commodity transactions.

Finally, Mazars supports the considerations of the Working Party in light of the determination of the quoted price and the adjustments to the quoted price to account for differences between the transactions evaluated and the comparable transactions found.

B. Deemed pricing date for commodity transactions

Mazars appreciates the Working Party’s concern that tax administrations may face difficulties in verification of the pricing date and, generally, welcomes the efforts put in the proposed amendment of Section B in Chapter II of the Transfer Pricing Guidelines. The wording of the proposal seems to imply that the concept ‘reliable evidence’ is to be determined at the discretion of a tax administration. We are of the view that this may lead to unintended results if a tax administration determines that no ‘reliable evidence’ is available, as they may then adopt a deemed pricing date (e.g. the date of shipment as evidenced by the bill of transport or equivalent document depending on the means of transport). Such may be the case with integrated structures, where a single company serves as a hub in the name of which all trades are concluded. In such structures, it is not uncommon that a standard framework contract is in place between the supplying company and the hub company, on the basis of which the intercompany pricing between those companies is determined. Via such framework contract, a standard price may be agreed upon to limit administrative burdens, of which the positive and negative results level out. In this situation, it is not unlikely that the involved tax administration would not consider the documentation for the intercompany transactions provided to be ‘reliable evidence’. Consequently, the quoted price at the deemed shipping date may be considered for tax purposes. In a large volume of trades, this implies a significant increase of the administrative burden for the tax payer, as well as results in a significant increase in deviations between the commercial accounts and the accounts for tax purposes. Also in these situations, the CUP method may be the best method, but it will be burdensome to allocate the profit to the several entities in different jurisdictions.

Furthermore, we note that tax administrations in various jurisdictions may have different views on the concept of ‘reliable evidence’. Therefore, we would welcome additional guidance and clarification on the concept of ‘reliable evidence’ and the practical implementations thereof. To the extent possible, we would propose to define the concept or to introduce a safe harbour to avoid uncertainty and discussions to the extent possible.

For completeness sake, please note that – as an example – the Dutch tax law already provides guidance with respect to the transfer pricing documentation needed. This guidance – article 8b of the Dutch corporate income tax act – is based on article 9 of the OECD Model Tax Treaty and prescribes that transactions between related parties should be conducted under at arm’s length conditions.
This should be documented properly. Consequently, similar to transactions between unrelated parties, the conditions of their commercial and financial relations (e.g., the price of goods transferred or services provided and the conditions of the transfer or provision) should be determined by market forces or corrected to resemble a price that would be applied between unrelated parties.

The analysis of the comparability of the controlled (related parties) and uncontrolled (unrelated parties) transactions is at the heart of the application of the at arm’s length principle. In order to determine whether any (and which) correction to the result of the related parties’ transaction is needed, a comparison between the conditions (including prices, but not only prices) made or imposed between related parties and those which would be made between unrelated parties is required.

In order for such comparison to be useful, the economically relevant characteristics of the situations to be assessed must be sufficiently comparable. Therefore, none of the differences between the situations being compared should materially affect the condition being examined (i.e., the price). In determining this comparability of the separate situations, the following five factors are generally—as you are aware—taken into consideration; the characteristics of the property or services transferred, the functions performed by the parties (i.e., functional analysis taking into account assets used and risks assumed), the contractual terms, the economic circumstances of the parties, and the business strategies pursued by the parties.

Most relevant for our response to this Discussion Draft on Action 10 is the functional analysis, as in transactions between two independent enterprises, compensation usually will reflect the functions that each enterprise performs (such taking into account assets used and risks assumed). That is, the more economically significant functions the party relatively is to perform, the higher the relative remuneration it is to receive. The functional analysis therewith seeks to identify the economically significant activities and responsibilities undertaken, assets used and risks assumed by the parties, which are crucial in the determination of the at arm’s length remuneration.

Crucial in this respect is that, according to the transfer pricing guidelines, a party cannot economically perform a function solely on the basis of a contractual allocation of a task or risk. As stated therein, the contractual terms and conditions of a transaction generally define explicitly or implicitly how the responsibilities, risks and benefits are to be divided between the transactional parties. However, where the conduct of the parties is not aligned with the terms of legal registrations and contracts, it may be appropriate to allocate all or part of the returns to the party that, as a matter of substance, performs the functions, bears the risks and bears the costs. Interested parties should provide more guidance and information on this and the Working Group could make a start of what kind of input they would prefer.

Moreover, the proposed amendment states that it is essential to permit resolution of cases of double taxation arising from application of the deemed pricing date through the mutual agreement process. We are of the view that the mutual agreement procedure as a method of dispute resolution is unsatisfactory, as an outcome is not guaranteed, and a procedure may take years to complete.
Therefore, we are of the view that the risk of disputes should be mitigated as much as possible and propose to adopt a clear definition and/or a safe harbour to minimize the risks for disputes.

Finally, not every tax treaty that is concluded between states provides for a mutual agreement procedure. Within the EU, a better result may be achieved by applying the EU Arbitrage Treaty as parties should reach an agreement within three years, unless in case of fraud. Therefore, and in order to assist companies in other non-EU states as well, we suggest to prescribe a dual audit between the states involved (i.e. reach an agreement on the modus of application). This procedure may provide a result quicker and also the costs for the tax payer should be less than when entering into a mutual agreement procedure, as the responsible authorities of both states jointly will perform the fact finding and take the same conclusions based on the same facts.

C. Potential additional guidance on comparability adjustments to the quoted price

We agree with the observation of the Working Party that the pricing of commodities should allow for comparability adjustments or differentials in relation to physical differences in the product, different specifications required, transportation agreements, processing costs and other tailor-made characteristics of a transaction.

Following the invitation of the Working Party, it is difficult to state when common adjustments to the quoted price should be made. In our experience, it is – if and when a CUP has been established – more difficult to allocate the profits between the entities and the several jurisdictions when splitting the services. In this respect, the following should be taken into account (as you may know):

i. type of commodities, the significant functions performed by the relevant people within the supply chain, the transportation methods and the like;
ii. type of contracts: a distinction should be made between – for instance – Free on Board (“FOB”) contracts and Cost, Insurance and Freight (“CIF”) contracts. For the FOB contracts, the transfer of the risk is considered to take place immediately after origination and before the transportation starts, while for CIF contracts the risk will be transferred at the moment the commodities will be delivered at its destination. Thus, with FOB contracts the prices should be lower as the risk will be transferred to the buyer earlier.
iii. wash outs should be taken into account. A wash out is a contract which will not result in a physical delivery as the position taken will be cleared for that time. How should the profit allocation take place?;
iv. who is responsible for a successful trade?, whom may legally bind the company, will there be a global book? etc. etc.
General observations and other remarks

Commercial and tax differences

It is not uncommon for trading companies that the valuation for tax purposes does not – in contrast to the valuation for commercial purposes – take the unrealised results on the forward contracts and the supply into account. Therefore, for commercial reasons a mark-to-market value will be used whilst for corporate income tax purposes another valuation, also differences can occur in domestic situations. As an example, please note that a mark-to-market valuation pursuant to Dutch case law can only be followed if and when real risks will be borne with respect to the unrealised result. When positions are hedged, it may not be possible to postpone the result. Thus, also in pure domestic situations a discussion between a tax payer and a local tax authority may pop-up occasionally. However, trading typically is an international business. Thus, as states have different views – with respect to valuation, the moment when profits should be taken into account and the like – how their commercial accounts and tax returns should be determined, the debates may be substantially more intensive compared to domestic situations. It will be quite a challenge to resolve these problems. More guidance in this matter would be appreciated as well.

European Market Infrastructure Regulation or Markets in Financial Instruments Directive

As you may know, the technical standards on OTC derivatives, reporting to trade repositories and the requirements thereof regarding the European Market Infrastructure Regulation ("EMIR") entered into force as of 15 March 2013 in Europe. Based on this new regulation, any entity that enters into any form of derivative contract, including interest rate, foreign exchange, equity, credit and commodity derivatives, should:

i. report every derivative contract that it enters to a trade repository;
ii. implement new risk management standards, including operational processes and margining, for all bilateral over-the-counter ("OTC") derivatives i.e. trades that are not cleared by a Central Counterparty Clearing House ("CCP"); and
iii. clear, via a CCP, those OTC derivatives subject to a mandatory clearing obligation.


The financial and commodity market is already regulated. The Working Group appreciates among others more evidence with respect to the quoted price. Would the EMIR or a similar regulation of an institute similar to the European Securities and Markets Authority (ESMA) not be the most appropriate way to follow these transactions in order to reduce a possible increase of administrative work load for trading companies? The Working Group’s view on this would be appreciated as well.
Financial Transaction Tax

In order to collect evidence with respect to the quoted price and to ease the collection for the parties at stake, it may be efficient to use the information collected for other taxes. In this respect, we would like to emphasize that it is envisaged that ten/eleven member states (please see the latest news on this as recorded on www.bloomberg.com dated 27 January 2015) of the European Union ("EU") may enter into force an EU Financial Transaction Tax ("FTT") as of 1 January 2016 (or some later date). Moreover, as the proposed FTT Directive uses a rather broad definition of "financial institution", the impacts could be bigger than expected. Even if those entities are not resident (in the regular tax sense) in a FTT country, they could still be considered a "deemed" resident (purely for FTT purposes), if they are engaging in financial transactions with counterparties resident in an FTT country and, consequently, subject to FTT. In addition, trades in financial instruments issued from within an FTT country will also be in scope, irrespective of the actual residency of the trading entities. Furthermore, physical commodity transactions will be exempt, but derivative commodity transactions will be in-scope. Albeit we appreciate that the FTT is an EU measure, other states also have a similar tax and Mazars would appreciate the view of the Working Group on this topic as well.

On behalf of the global network of Mazars Member Firms, we submit our response to the Discussion Draft on Action 10 of the BEPS Action Plan on the Transfer Pricing Aspects of Cross-border Commodity Transactions. For any clarification of this response, please do not hesitate to contact the undersigned.

Yours sincerely,

Ton Tuinier
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Dick van Sprundel
International Tax Partner at Mazars Netherlands
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Comments on BEPS action 10: Profit Split in the context of Global Value chains

Dear Andrew,

MEDEF is pleased to provide comments on the OECD Public Discussion Draft on Action 10: “Transfer Pricing aspects of cross-border commodity transactions” issued on 16 December 2014 (hereafter “the draft”).

French companies consider OECD’s work in general and BEPS Action Plan in particular as crucial if it is to provide a fair, competitive and coherent global fiscal landscape. The forthcoming changes are numerous and will have a gigantic impact on the running of their business. Companies are in the best position to identify difficulties related to implementation, to give feedback on the practical feasibility and to geographically and temporally assess the OECD proposals. They believe, however, that the operating mode, process and time-frame are inadequate to ensure a full and comprehensive analysis of the draft submitted for consultation. They regret the strengthening of this trend which will be detrimental to all: companies and Governments.

We hope our contribution will give you a clearer insight into our expectations and remain at your disposal for further information.

Yours sincerely,

Vanessa de Saint-Blanquat
General comments

The OECD reports that some countries face difficulties pricing cross-border commodity transactions, particularly in terms of determining adjustments to quoted prices, verifying the pricing date, and accounting for the involvement of other related parties in the supply chain. These difficulties have led to the emergence of simplified, but heterogeneous, domestic approaches for pricing commodity transactions some of them being referred to as the “sixth method”.

In an attempt to reconcile those local approaches with the general arm’s length principle, the OECD proposes additional guidance to the existing Guidelines that would be specific to the commodity transactions. The Discussion Draft recommends the use of quoted or publicly available prices (“quoted price”) for the application of the CUP method and introduces a special rule for pricing date convention. The objective is to facilitate the mission of the tax authorities by simplifying the application of the CUP method but still remaining “within the arm’s length principle”.

A consistent set of arbitrary rules would not always be consistent with the arm’s length principle and might require material and or complex adjustments which should not be underestimated. The simplification expected is therefore far from certain. What matters the most for industry players undertaking commodity transactions is to be able to apply the arm’s length principle to limit competition issues or double taxation.

The Discussion Draft seeks to ensure that pricing reflects “value creation” (Section I, Paragraph 6). However we believe that the use of “quoted prices” does not guarantee such alignment in all circumstances. Therefore, it is unclear why a prescriptive guidance would be preferable compared to the general principles and the associated analytical framework under existing recognized Guidelines.

The Discussion Draft states (Section I, Paragraph 7) that a prerequisite for the implementation of the proposed guidance is that tax authorities improve their knowledge on the functioning of the commodity markets and businesses. Otherwise, there is a significant risk of arbitrary position which would lead to double taxation hindering cross-border trade and investment.

We fully share this recommendation since it is also our experience that tax authorities have difficulties to properly understand the economics of the commodity transactions which prevent them from understanding the rationale behind the price formula and the various adjustments. Since tax authorities often are suspicious toward complex related transactions, arbitrary reassessments are a real concern for businesses.

The Discussion Draft suggests that comparability adjustments can be an answer and that a working group will further investigate them for the mineral industry. We believe that adjustments to a “quoted price” can be irrelevant or impractical or can lead to complex or material adjustments which are unlikely to provide a reliable result. Industry players should have the flexibility to select the relevant comparable uncontrolled transaction (including “quoted prices” having regard to the purpose of the controlled transaction, and their knowledge of economic context, industry and business models).
Comments on Section II, Paragraph 8 and 11

We concur that potential comparable uncontrolled transactions (internal and external), including “quoted prices”, should be considered as a benchmark for the application of the Comparable Uncontrolled Price (“CUP”) and that this selection should be subject to a strict comparability test having regard to circumstances and industry practices. Such approach already exists in the current version of the OECD Guidelines without additional prescriptive guidance.

However, industry players should still have the flexibility to choose the method because the CUP method is not always the most relevant considering the functional analysis or conform to market practice for some commodity transactions. Below are few examples in the energy industry illustrating this point:

Example 1: Company A and Company B are located in different countries but yet are sharing a common book for trading commodity in the market. The bi-localized desk use a profit split method to share the associated profits or losses. The CUP method (and the “quoted price” approach) is therefore not appropriate.

Example 2: Company A planned to sale a cargo of Liquefied Natural Gas (“LNG”) to Company B but the parties agree to divert this cargo and sale it to a third party at a higher price. The market practice is to apply a predefined profit split mechanism to share the profit upside. The CUP method (and the “quoted price” approach) is therefore not appropriate.

Example 3: Tolling agreements in the power industry (common practice) involve a toller (owner of the power plant) who receives a predefined fee from the owner of the gas (tollee) in exchange for the right (but not the obligation) to use the power plant to transform the gas into power, and thus, commercialize the resulting electricity off-take. The tollee has the responsibility to optimize the plant thereby supporting all market and operation (outage, de-rating, reduced efficiency, non-delivery of gas cargoes, etc.) risks associated with those assets. The fee is usually based on the investment or replacement value of the plant ensuring an appropriate return on investment to the assets' owner and the operating expenses. Depending of the initial negotiations, the fee can be fixed over a long period of time or can be amended after a certain period (through a revision clause or a hardship clause). The CUP method (and the “quoted price” approach) is therefore not appropriate.

Example 4: Company A commercializes power to industrial clients with price formula including tailored indexes and optional elements. Company B centralizes many functions primarily to benefit from economies of scale and improve risk management (i.e. power generation, portfolio management and optimization, risk control and hedging, storage and transmission, network balancing, etc.) and supplies all its related commercialization entities with fully flexible volumes using formula that are tailored to end customers’ requirements. Having regard to its functional profile, Company A receives remuneration consistent with an independent commercialization entity using some sort of Cost Plus
approach (net-back approach that might use quoted prices) or TNMM method. Considering the functional analysis, the CUP method (and the “quoted price” approach) is therefore not appropriate.

Even when the CUP is consistent with the functional analysis, internal comparable uncontrolled transactions should not be given a lower priority, as they usually represent a more direct application of the arm’s length principle.

Example 5: Company A operating in an illiquid market sources its natural gas through two mid-term supply contracts of which one is entered into with an unrelated supplier. The uncontrolled transactions associated to the supply contract with the third party should be considered. The alternative “quoted price” approach could be to use the closest connected market reference adjusted for transportation capacities. However, the transportation capacities are very limited and therefore transportation expensive, in addition both mid-term contracts include a significant volume commitment and an oil-indexation, which makes any adjustments irrelevant. The reference to internal comparables is more appropriate than the reference to the local quoted price.

Comments on Section II, Paragraph 9 and 12.2

We understand that “quoted prices” can be legitimated under the arm’s length principle because they are external references which are assumed to always reflect the interaction of the supply and demand.

“Quoted prices are not set by a single individual or entity (except in the case of governmental price control), as they are the result of the interaction of supply and demand in the market for a certain quantity of a type of product at a specific point in time [...] In addition, there is considerable evidence that quoted prices are used as benchmarks or markers to price commodities in transactions between unrelated parties.”

We concur that industry players undertake numerous controlled transactions (both on physical commodities and financial derivatives) associated with activities such as sourcing, hedging, optimizing, balancing and for which “quoted prices” (spot, forward, future and option) can be relevant for the application of the CUP method.

However, industry players typically use “quoted prices” as a reference to price standard products traded in a liquid market/horizon. The sentence “for a certain quantity of a type of product at a specific point in time” (similar wording in Paragraph 12.2) does not sufficiently underline this essential condition.

“Quoted price” in a market with too few transactions should not be used because such quoted prices do not reflect the interaction of a sufficient number of supply and demand (few suppliers and few buyers) to be recognized as a reliable reference. The same comment applies for forward prices when the number of transactions is not sufficient to have a reliable quotation (over a 3-year period usually for power and gas).
Industry players would rather transact on the Other The Counter ("OTC") market and establish their portfolio management and pricing strategy using stable (rather than volatile) references that can provide some visibility on the market (over the liquid horizon).

Example 6: natural gas markets which are not well connected with transportation capacities are usually recognized as illiquid (eg Spain and Italy in South Europe). In the absence of a reliable local quoted price, industry players might use alternative references such as the “quoted price” of the closest liquid market adjusted for transportation, LNG prices adjusted for transportation and re-gasification, local bid offers or similar local benchmark developed amongst local players.

A standard product in a liquid market relates to a commodity transaction of a “standardised size”. Whenever a related party requires to trade bigger sizes, the price of the commodity transaction should most of the time differ from the “quoted price”. As mentioned above, the less liquid the commodity market is, the more important the deviation should be.

For instance, an issue may arise for big players that need to supply large volumes while the local organized market is not “deep” enough to source such volumes at all times and circumstances. A relevant price reference for such controlled transactions could be references from quoted prices of deeper connected markets (corrected with transportation costs) or long term supply contract prices (because the volume commitment from the E&P supplier is the easier way to secure large volumes at all times and circumstances).

Example 7: Company A is the largest provider of energy in Country A and is required by local authorities to provide a security of supply to avoid any interruption of supply to households. Local available volumes on the spot market are not sufficient to guarantee the supply at all times and circumstances. Company A had to enter into medium or long term supply agreement with its related suppliers to secure a certain volume at all times. The supply contract formula includes an indexation which is disconnected from the local spot “quoted prices” because the factors that influence the indexes and the local “quoted prices” differ significantly. In its relations with Company B (marketing entity), Company A will not be able to only refer to the local quoted price. For the computation of the flexibility component of the supply, it will also take into consideration the price of its medium/long term contracts.

**Comments on Section II, Paragraph 12.1**

The Discussion Draft seems to justify the selection of the CUP method by the existence of “quoted prices”, which is not consistent with the more comprehensive approach of the OECD Guidelines i.e. taking into account i) the respective strengths and weaknesses of the methods, ii) the nature of the transactions including the functional analysis, iii) the reliability of available information, iv) the degree of comparability between controlled and uncontrolled transactions).

The Discussion Draft refers to “commodities” as transactions including “physical” products. However, numerous controlled transactions are financial derivatives with a physical commodity as
underlying. Financial products are more likely to be traded using a “quoted price” and be adjusted using standard approaches

**Comments on Section II, Paragraph 12.2**

The Discussion Draft proposes to include the “prices obtained by governmental price-setting agencies” in the proposed sources of “quoted prices” for the application of the CUP method:

“[…] represented by the quoted price of the commodity in the relevant period obtained in an international or domestic commodity exchange market. In this context, a quoted price also includes prices obtained from recognized and transparent price reporting or statistical agencies, or from governmental price-setting agencies, where such indexes are used by unrelated parties to determine prices in transactions between them.”

We agree that the regulated price should be used as the reference for transactions undertaken by the supplier of the commodity since regulated prices are identical for both controlled and uncontrolled transactions. For example, a regulated price for a power plant or transmission grid might be based on the investment or replacement value methodology in order to ensure an acceptable return to the “Producer” on the large capital expenditure (“CAPEX”) required building the local assets. For the oil industry, source countries increasingly refer to prices set up by governmental agencies to fix the selling price between the entity owning the license and a related entity buying the crude oil to refine it or resell it.

However, regulated prices might also be established by government price-setting agencies with an objective that conflicts with the arm’s length principle. For example: a regulated price imposed by authorities on a predefined volume of commodity (e.g. power) to temporarily encourage the competition in a domestic market or to control the price to end customers. This regulated price should not be considered as a reliable reference because if it does not reflect the interaction of supply and demand.

Industry players can usually exchange the commodity amongst each other (either originally purchased from the regulated supplier or from local production or importation) using a “market price” that is influenced by various external factors (e.g. climatic, economic, regulatory, technology, natural event, etc.) affecting the level of supply and demand. Hence, a company will agree to pay the regulated price (in the context of a controlled or uncontrolled transaction) solely if it makes economic sense having regard to alternative options available.

**Comments on Section II, Paragraph 12.3**

We agree that similarities between controlled and uncontrolled transaction should be reviewed having regard to the comparability factors. However, when differences materially affect the price and that no reliable adjustment can be performed, another method should be selected. The OECD Guidelines already provide relevant guidance for the application of the CUP method using relevant uncontrolled comparable transactions and referring to industry practices or, when necessary, rely on methodological approaches based on the options realistically available or the respective bargaining power.
Regarding comparable data used to apply the CUP method, industry players often use price formula based on one or a combination of “quoted prices” following a sound business rationale (indexation which makes sense from a business standpoint). Such price formula will fluctuate and is very unlikely to reconcile with the local “quoted price” of the commodity at the delivery date. Market pricing of products can be defined based on a formula taking onto account product components and other parameters such as density, purity, index, conversion factors.

Example 8: Company A purchases natural gas from a related E&P Company using a formula based on oil indexes, and Company A re-sells natural gas to Company B which operates a gas-fired power plant using a formula indexed on power prices. The functional analysis and more specifically the identification of which entity bears what market risk is key in the definition of the internal price signal.

The price conditions foreseen in energy supply arrangements including a volume commitment over multiple years are typically expressed as a formula which includes a “price level” and an “indexation”. The former represents the price that was agreed by the parties (at inception) and the later provides the reference(s) upon which the price will fluctuate overtime. Relevant “quoted prices” can potentially be used as a reference to establish the price level at inception but then prices fluctuate according the contractual indexation.

The graph below illustrates this comment:

We agree that “quoted prices” can sometimes be used as a reference for non-standard products but the relevant adjustments should be made to satisfy the level of comparability required under the arm’s length principle. Such adjustments could relate to the intrinsic feature of the product, to the terms of the transaction, as well as to functions and risk undertaken by the parties. Value-added functions could be performed by the parties in relation to the commodity being transferred (transportation, distribution, trading...). Risks could also be incurred for example in relation to INCOTERMS, credit, timing. We understand that research will be undertaken as part of the Tax and Development Program to identify common adjustments. The scope of commodity is large and implies different business models. The understanding of the various markets and industry practices will be critical to ensure a proper treatment of such adjustments. We observe that such adjustments might represent a large portion of the final commodity price.
Set out below are some examples of comparability adjustments performed in the energy industry.

✓ The differences of calorific value of the commodity is typical in the energy industry especially for the coal, biomass and natural gas. The natural gas can also be slightly modified to have certain properties such as a specific odor (imposed by regulation). Similarly, quoted prices for LNG must be adjusted to account for the access to re-gasification capacities. Approaches used to perform the adjustments are quite specific but usually applied to both controlled and uncontrolled transactions.

✓ As previously mentioned a long-term agreement with a volume commitment and price formula represents a large risk for the parties. Such agreements are particularly relevant to ensure a security of supply (no interruption) to the client at all time and circumstances. The price agreed upon under such agreement should not be compared with the spot market prices.

✓ Adjustments are usually performed to the commodity in the energy industry to account for the flexibility and/or modulation of the contract (capacity to adjust the volumes during a given period). The seasonal flexibility and modulation reflect the variation in consumption between the various seasons. Depending on the cases, the pricing is based either on the storage costs (building stocks in summer), or on market price differentials (price variation between winter and summer).

✓ Another typical adjustment is to account for the transportation of the commodity to the delivery point. As mentioned above the main price reference might be established in one geographic area recognized as the price reference. A relevant quoted price for another delivery point can be calculated by adding the relevant transportation costs such as train (e.g. coal, biomass), cargo (e.g. coal, LNG, petrol), transportation capacities (natural gas), transmission capacities (power).

✓ A renegotiation of long-term agreement might require adjusting the historical price using the approach where the alternative options available for the parties are examined and their respective bargaining power to find a realistic outcome at arm’s length.

✓ Premium or demium could apply to commodity transactions according to their quality and origin, for example as far as different types or crude are concerned.

Comments on Section II, Paragraph 12.4

The access to the financial market is usually made through a controlled entity with an “investment services provider” status. As such regulated entities are already compelled to prove that they apply fair prices to all their customers under local regulation from a regulatory standpoint, and since they undertake numerous transactions on a daily basis, additional guidance would be welcome to simplify their documentation requirements for transfer pricing purposes (i.e. documentation by
categories of transactions and not transaction by transaction, documentation of pricing processes rather than the transactions themselves).

**Comments on Section II, Paragraph 13**

We are not aware of consistent industry practice where fixed prices are calculated using averages. It should be noted that indexes (either spot or forward prices) can themselves be based on a rolling average of prices.

It should be noted that losses/gains occurring from a de-correlation of purchase/selling prices due to significant and durable changes in market conditions (i.e. not possible to hedge) for various reasons (e.g. climatic, economic, politic, regulatory, technology, natural event, etc.) is one of the features of business models in the industry. Hence, an external event might occur further to a transaction for a large volume with no intention to manipulate the prices.

**Comments on Section II, Paragraph 14 and 15**

We understand that certain tax authorities face the challenge of verifying the pricing date. As a result, the Discussion Draft introduces a special rule to arbitrarily provide a “deemed pricing date” in the absence of reliable evidence of the date actually agreed by the parties. However, we believe that, in case pricing date basis is in line with market practice, which differs from the deemed pricing date, the burden of proof should lie in the hands of the tax administration contrary to what is stated in the draft.

The Draft is also unclear on the definition of “reliable evidence”. Further details are required to understand what evidence is considered reliable or not.

*Where the taxpayer can provide reliable evidence of the actual pricing date agreed by the associated enterprises in the controlled commodity transaction, tax administrations should take the actual pricing date as a reference to determine the price for the commodity transaction. [...]*

We suggest distinguishing the following three different cases:

- **Case 1:** SPOT transactions whereby the volumes are sold for immediate delivery. The price reflects current market conditions at delivery date.

- **Case 2:** Transactions undertaken under middle to long term agreement where the volumes are sold using a price formula computed at the time of the delivery.

The date used for the computation of a price formula (SPOT transaction or predefined formula in a supply contract) is typically the delivery date of the commodity. The price formula foreseen in middle to long term contracts can (and should) be modified by the parties following price revision
clauses (regular price revision, hardship clause, competitiveness clause, etc.) which are included in third party agreements.

Example 9: Company A entered into a long-term supply agreement (20-year period) of natural gas in January 2005 which foresees a price revision clause to be triggered under certain economic circumstances. The clause was triggered in September 2010 and the negotiation ended one year later with a retroactive effect at the beginning of the Gas Year 2010-2011 i.e. October 2010. All volumes associated to this Gas Year will be subject to the new formula.

✓ Case 3: FORWARD transactions whereby the volumes are sold for future delivery. The price reflects market conditions at the fixing. Commodity prices agreed in advance can either be a fixed price or a price formula based on one or multiple indexes.

For forward transactions the date at which the parties agreed for the fixing will apply. In such case, confirmations by phone, e-mail, or through an official management committee can provide the evidence of the date at which the forward price was established. Numerous transactions are undertaken using forward prices in the industry. In no circumstances the delivery date would be relevant to compute the formula because the buyer establishes its business strategy based on the fixed price.

Example 10: Company A purchases large volumes of LNG under a delivery program with fixed dates and prices. Some of the volume is reallocated to various clients distributing LNG via trucks or local natural gas companies located in many countries in Asia and Latin America. The sales to third parties clients are made under mid-term supply contracts and Company A hedges its portfolio with financial products, all that is based on the fixed price agreed with its controlled company on forward prices.
BEPS Action 10: Discussion draft on the transfer pricing aspects of commodity transactions

Comments by NERA Economic Consulting

Dear Mr. Hickman,

We would like to thank the focus group for the possibility to provide comment on the discussion draft on transfer pricing aspects of cross-border commodity transactions. The discussion draft provides a summary of some key issues faced by both tax authorities and taxpayers in this context. It also develops further guidance, in the broader context of the application of the CUP method, so as how to assess the pricing date in case the taxpayer is not able to provide reliable evidence in this regard. We provide below our comments on the key items highlighted in the discussion draft.

I. The use of the CUP method

The current wording proposed emphasises the use of the comparable uncontrolled price method. There is no doubt that the comparable uncontrolled price method is a useful approach when it comes to evaluating the arm’s length nature of commodity transactions. However, the reliance of this method, as also pointed out in the discussion draft, is very much dependent on the extent to which accurate adjustment can be performed given the facts and circumstances of the case. In this context, it may be useful to better link the concepts introduced in Chapter VI to this discussion draft. Namely, there are instances where the intra-group transaction would need to reflect the intangible contributions of other parties.

More generally, one would need to acknowledge that other transfer pricing method may very well apply to transactions relating to commodities. The Discussion Draft is silent on those at this stage.

The determination of remuneration and consequently the appropriateness of the quoted market prices as comparable uncontrolled price approach will depend on the value contribution and risks assumed by a particular entity to the overall value creation process. Commodity pricing may be influenced by a number of factors including for example political, regulatory, climatic risk factors, etc. which are often difficult to adjust for. These can affect the comparability of quoted market prices. In addition and perhaps most importantly, in some commodities market, publicly available pricing data tend to refer to transactions between parties that are in essence short term or opportunistic. Whilst in an intra-group context, the transactions may be long term and cooperative. It may be that commodities futures prices could partly address such issues especially in periods of significant changes in spot prices that were unanticipated in futures contracts previously concluded. In these contexts, the use of the CUP method may provide some indications of market prices, but is likely to necessitate further adjustments to reflect the difference in the nature of the relationship in the intra-group context vs. what is observed on the market. We note that the relationship is not an OECD comparability factor. Arguably, one could include it in the “economic circumstances”
comparability factor. We believe that making this factor explicit would help in addressing the specificities of commodity transactions.

In all cases the appropriateness of the comparable uncontrolled price method versus alternative methods should be considered in context of a detailed value chain analysis, carefully considering the risk factors an entity is exposed to, and given the market they operate in.

II. Adjustments

The nature of the adjustments required and the validity of the approach should be based on a detailed analysis of the relations amongst related parties and circumstances under which a transaction occurs. Such analysis involves evaluating each party’s value contribution to the overall value creation process, a careful consideration for risk assumed in markets in which the respective entities operate and an analysis of the potential difference in terms of the nature of the relationship as mentioned above. The current discussion draft alludes to the importance of this but more emphasis should be put on the importance of a detailed value chain analysis in the context of commodities. Such an analysis will provide the necessary tool set to aid the allocation of revenues (profits) to the respective entities and hence what adjustments may be needed. Please note however, that the value chain analysis should not aim at providing a substitution for the CUP method (or any other method), but rather to facilitate the application of the method. In this context, the use of industry standards can be useful information in the context of transfer pricing analysis but it may not substitute an in-depth analysis.

There are a large number of factors for a given commodity that can influence pricing. Examples include the commodity itself (e.g., quality in the case of crude oil), geography and the political landscape in which the respective entities operate (subsidies, regulation, tariffs etc.), size of the deal, business cycle and demand, and other factors such as the types contractual arrangements and related features, and economic conditions, to name a few. Thus, in most cases some sort of adjustment is unavoidable when considering dealings between entities of a particular group and relying on the comparable uncontrolled price approach. We do not believe that it is neither possible nor desirable for the OECD to attempt to list out let alone standardize the adjustments that are needed. Such adjustments should be case specific and reflect the contribution to value creation of the parties, the transaction at stake and the industry. In other words, there should not specific comparability criteria relating to commodity transactions.

The arm’s length standard should be applied equally across industries and transactions. Introducing industry or transactions specific guidance would introduce uncertainty, complexity and likely provides opportunities for BEPS.

III. Timing of the Transaction

From an economic perspective, actual shipment or trading dates can be relied upon as indication of when a transaction has occurred. Since market prices can vary daily, using market data over a period prior the shipment or trading provide an indication of a range of market prices also taking into account daily volatility of the underlying commodity price may be relevant, although even this would depend on the facts of the case. The frequency of data available for a particular commodity
can assist in determining the approach that can be relied upon on establishing the appropriate time period over which to analyse market data. In this context, the analysis should reflect the nature of the relationship between the parties. It may not be suitable to systematically rely without adjustment on short term spot transaction in the context of an inherently long term relationship. The timing of the transaction and the prices used as comparable should reflect potential differences in relationships.

In any event the dates to be evaluated and the approach to be followed should be based on the type commodity, the type contract, and the conditions in which the trade occurred.

**Concluding Remarks**

The discussion draft provides revised contents on the use of the comparable uncontrolled method and request feedback on typical adjustments to be relied upon and pricing date of the transaction in the context of commodity pricing. In our opinion,

- The analysis of commodity transactions should not be restricted to a discussion of the CUP method.
- The application of the arm’s length principle for commodities transaction should not be different from the application of the arm’s length principle for any transaction or industry and in particular there should be no commodities-specific adjustments prescribed for in the Guidelines

**Amanda Pletz, Emmanuel Llinares**  
*London / Paris*  
February 2015
February 6, 2015

Dear Mr Hickman,

Comments on the Discussion Draft on the Transfer Pricing Aspects of Cross-border Commodity Transactions

Thank you for the opportunity to provide comments on the Public Discussion Draft on BEPS Action 10: *Discussion Draft on the Transfer Pricing Aspects of Cross-border Commodity Transactions* (the “Draft”), dated 16 December 2014.

PricewaterhouseCoopers LLP (“PwC”), on behalf of its international network of Member Firms, agrees with the OECD that ensuring a consistent transfer pricing approach to commodity-related transactions globally is important in protecting the consensus built around the arm’s length principle. We also appreciate that tax authorities in developing countries have expressed concerns about the potential for the erosion of their tax base in relation to these transactions.

PwC supports the OECD’s efforts to facilitate the administration of the arm’s length principle in this specialist area. However, we are concerned that the language of some of the suggestions in the Draft may require some further clarification; both to become more meaningful for tax authorities to monitor and administer, and to become more consistent with existing market pricing to allow effective implementation by taxpayers. In the remainder of this letter we have identified a number of items for further consideration by the OECD in its next version of the document.

**Detailed Comments:**

1. **Application of the comparable uncontrolled price (CUP) method**

The Draft recognises that the use of quoted prices for commodity transactions between associated enterprises corresponds to the application of the CUP method. We support this reconciliation of the so-called sixth method with the OECD recognised methods as a sensible approach, preserving the consensus reached throughout the years.

PwC recognises that there are cases where the value chain is so integrated that, even though open market quotes exist, the applicability and reliability of the CUP method should not be taken for granted, but instead be assessed in the light of the 9-step comparability process described in Chapter III of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.
("Transfer Pricing Guidelines"). The most common example of such a situation is where related parties engage in highly integrated activities – for example by trading through a single book, where some subsidiaries originate products, while other related entities hedge and market the consolidated position and provide the capital (e.g. through payments in advance). For some of those arrangements, other methods (e.g. the profit split) might be appropriate and indeed better aligned with the arm’s length principle than the CUP method.

We further suggest that, when the CUP method is indeed the most appropriate, the wording is inserted to directly refer to existing guidance on the CUP method in order to minimise the potential for arbitrary use of the commodities paper as the only guidance in this area. We welcome the wording to be added to the body of the Transfer Pricing Guidelines as summarised in para 12 and suggest clarifying the wording of para 8 to be aligned with para 12.

In addition to preserving consistency, this would also address one of the ambiguities of the current Draft, i.e. limited reference to the internal comparable transactions which are commonly used by taxpayers. A reference to internal comparable transactions is likely to be welcomed by taxpayers who, in our experience, replicate market pricing for commodity-related transactions by pricing their transactions in a number of different ways, rather than just through the use of simple market reference prices.

A case in point is where third parties price transactions through a formula instead of using a single quote. In such situations, it is not uncommon that at the date of agreement third parties agree on the quantity and quality of the goods, delivery terms and conditions, price base (i.e. a reference to specific market quote), fixing date(s) or quotational period (i.e. the future date(s) when benchmark quote(s) are to be fixed) and any other premia or discounts. The current wording of the Draft can be read as imposing the use of a single price/quote on a particular day which might not be aligned with such a third party behaviour.

The consistent use of a month average is another common method used between independent parties to fix the price base, eliminating the risk of creating a winner or loser from the exact timing within a month of a sale or shipment, and the same logic applies within a group. Such monthly averages (up to several months after the date of delivery) are commonly used in transactions involving commodities that require further processing before being readily marketable. The purpose of employing long quotational periods is to allow the refiner or processor to match the costs of inputs with the income derived from the sale of the commodity, whose transformation may require significant time, as well as to allow for effective hedging of the price risk.

Accordingly, while in certain cases the reference prices referred to in the Draft should be seen as a good approximation of spot pricing, the reliability of data reports varies depending on the transparency of the relevant market, the liquidity in that market, the nature of the commodity and the existing market practice, such as the examples described above.

Since the quoted (or reference) price is an exact number there is a huge risk of spurious precision (i.e. the number is taken as an objective truth) or ambiguity (e.g. when a whole range of high-frequency bid-ask mid-point quotes exists spanning a wide intra-day minimum-maximum range). The actual truth is that even before making the necessary adjustments (e.g. for quality, geography, level of the market etc.) independent transactional prices have occurred and will occur in a band around that
number and that band is narrower or wider depending on a range of factors including liquidity or intra-day price volatility.

This is consistent with the OECD’s long standing recognition of what quoted and reported prices usually are and a reference to para 3.55 and, in particular, the final sentence of that paragraph would be appropriate (“It is also possible that the different points in a range represent the fact that independent enterprises engaged in comparable transactions under comparable circumstances may not establish exactly the same price for the transaction”). This is undoubtedly true for commodity transactions, particularly when it comes to the adjustments that need to be made.

In summary, to account for these unique industry-specific facts, the OECD should encourage the use of taxpayers’ own evidence of their internal data for application of the CUP method to establish at the very least which reference prices are the most appropriate (or how adjustments are made) or to confirm if a different methodology would be more appropriate.

2. Scope of the guidance

Just as commodity-related transactions are critical to developing countries, they are also fundamental to many supply chains. Accordingly, the guidance in the Draft is potentially widely applicable and its reach will go far beyond the extractive and agricultural sectors. PwC would support the inclusion of additional wording which explicitly states that the guidance provided applies to a range of industries i.e. those businesses that use and consume commodities as well as those producing them.

The paper does not specify what commodities are in scope, defining commodities as "physical products for which a quoted price is used by independent parties in the industry to set prices in uncontrolled transactions". PwC’s concern here is that such a broad definition might result in the application of quoted prices/ adjustments/ deemed pricing to all products for which quoted prices exist, without verifying if these quoted prices meet the comparability thresholds required for reasonable and defendable CUPs.

Accordingly, PwC would welcome the final version of the Draft to distinguish between reference prices that are widely used to price independent transactions and those which are published ‘for information’ and are based merely on anecdotal evidence alone. In the latter case the only appropriate use that is consistent with the arm’s length principle is as a sense check with the opportunity to explain differences between the prices used and those reported.

Conversely, in some cases useful quotes exist that allow for the pricing of non-physical services or activities critical for commodities transactions, for example shipping, virtual storage (economically corresponding to the function of forward and spot times) or risks (the risk of keeping inventory of a certain commodity includes the risk of its price changing while in storage, which can be hedged e.g. using options, and which can be priced using market quotations).

PwC believes that taxpayers would benefit from guidance contained within the Draft when pricing these, so the definition could be further expanded, for example to "products and services for which a reliable quoted price is used by independent parties in the industry to set prices in uncontrolled transactions".

For a number of commodities, there are already well established industry conventions in place to price the sale of the products. We strongly support the wording in the current Draft that a "relevant factor
in determining the appropriateness of using the quoted price for a specific commodity is the extent to which the quoted price is widely and routinely used in the ordinary course of business in the industry to negotiate prices for uncontrolled transactions comparable to the controlled transaction”.

3. Adoption of a deemed pricing date for controlled commodity transactions in the absence of evidence of the actual pricing date agreed by the parties to the transactions

While clearly important given the scope for misuse and base erosion, we believe that the focus of the guidance should be on determining an arm’s length price rather than focusing solely on the deemed date, which is only one of the elements of pricing in complex industries relying on commodity-related transactions.

We believe that what the OECD intends here is combatting deliberate base erosion rather than establishing a general principle along the lines of the existing text at paras 1.67-1.69 of the OECD Guidelines. If so, it would be helpful if that point were made more clearly and if it were recognised that consistency will often be an appropriate safeguard. For example, if spot transactions are always priced on the day of shipment there is no scope for manipulation. Similarly for term contracts (which will typically be the case for related party transactions) the use of month averages or other quotational period triggered by observable events (shipment date, arrival date, laydays, etc.) as noted above will usually eliminate the potential problem.

The reference to deemed transaction dates without appropriate clarification is particularly problematic given the breadth of application of this guidance (see above) because so many commodities with very different characteristics are affected. The agricultural sector is a good example as crops may be purchased well before harvest or even planting and thus well before quantities, qualities and shipment dates are ever known. Again, consistency and clarity in transfer pricing policies (addressed by a number of other recent OECD papers) will be an appropriate safeguard. PwC suggests that greater clarification is added in relation to the issue being addressed with reference to the existing guidance at 1.67-1.69.

In this regard, it is advisable for the concept of “reliable evidence” referred to in paragraph 14 of the Draft to be further expanded, as its current wording is open to interpretation, thus potentially increasing the administrative burden or setting reliability thresholds that could not be met by the taxpayers under any circumstances (i.e. requiring the contracts to be physically signed by the parties before a notary, when their representatives are based in different locations). In this sense, the practical experience of some Latin American countries that have applied the so-called sixth method provides valuable experience on this matter.

Moreover, the pricing date concept itself should be further clarified and linked to internal and external market evidence. This should allow taxpayers to follow market practice, for example with respect to the commonly used formulae pricing mechanism where there is more than one date in which the price is determined (e.g. the date when the agreement is executed and the quotational date or period in which the quote(s) applicable are determined and the final price is calculated).

Finally, PwC suggests wording be incorporated clarifying that where (under clearly defined circumstances) the pricing date is disregarded, the deemed pricing date must be applied consistently in every transaction, not only where it increases tax base.
4. **Input requested on potential additional guidance on comparability adjustments**

PwC welcomes the explicit recognition of the need to adjust the market quotes used in pricing for economically significant factors. In our experience, commodity-related adjustments are often significant (in particular transportation and product-specific premia/discounts) and because they are additive may result in significant differences between the final price and the reference price particularly when dealing with intermediate products i.e. those requiring further refinement or processing. We believe this fact should be explicitly recognised to avoid controversies between taxpayers and tax authorities.

For certain commodities quoted in liquid markets by recognised and reliable data providers, pricing methodologies already exist and are publicly available. As these describe in detail the key material adjustments made to prices by third parties to turn them into publicly available and standardised quotes, this information might easily be reverse engineered to identify the key adjustments to be made.

We note that recent clarification of the Brazilian ‘PECEX method’ enumerates a range of adjustments which, subject to application in practice, appears consistent with the OECD’s reconciliation with the CUP method. Those adjustments include: market premium (market valuation, quality, characteristics of the product and substance content), business conditions (terms of payment, negotiated quality, climate influences in the characteristics, intermediation costs, packaging, freight and insurance, cost of landing, storage, customs and taxes). More pertinently, these identify the nature of the adjustment without undue specificity on the application of the adjustments on the basis that market evidence will usually exist (externally or internally) to demonstrate how these are made and in what magnitude.

For commodities/markets where less reliable data is available or where industry practice is more varied, the evidence may be supplemented or adjustments deduced from other commodities with similar market or industry characteristics. It would not be advisable to create a closed list of factors to adjust for as these will vary by commodity, increase the compliance costs, and essentially magnify the risk of economic double taxation.

5. **Disclosure**

Although we fully support transparency and disclosure as part of the documentation process, it is important that the OECD recognise that often the data required to apply the CUP method to commodity transactions is often commercially sensitive (particularly for internal data) and public disclosure or application may have legal or regulatory implications (e.g. competition law). As the effect of other recent papers by the OECD may well be that documentation becomes more widely distributed, the current wording of the suggested addition to 2.16 item 4 in Section B in Chapter II of the Transfer Pricing Guidelines is potentially problematic and may actually impede the best use of the evidence available.

It would be helpful if the stipulations of item 4, para 12 were clarified to make it clear that documentation should establish the principles of the calculation. The detailed market data (external or internal) for applying the calculation to any shipment or period would, of course, be available to the relevant tax authorities either in a local file or on request.

Given the risk of spurious precision that arises from the use of quoted or published reference prices (for the commodities themselves as well as for adjustments) and the OECD’s long standing recognition of the appropriate use of ranges, this would also help focus on the most material elements of the
pricing formulae and analysing their economic impact and importance. This is likely to be a much more efficient use of tax authorities’ (and taxpayers’) time and resources.

6. Other comments

Many points made in the Draft will be affected by other BEPS action points (in particular the Discussion Draft on the Use of Profit Splits in the Context of Global Value Chains and the Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterisation, and Special Measures)) or the existing Transfer Pricing Guidelines. It is highly likely that the final version of this paper will be referred to extensively by tax authorities and taxpayers alike. It would be helpful to provide some clarity on scope. For example, is it merely intended as a reconciliation of the so-called sixth methods to the CUP method or is it intended as formal guidance on the specific transfer pricing analysis required for commodity transactions and to be linked up to guidance on other matters, such as the use of profit splits.

Although in principle PwC supports the OECD’s view that the mutual agreement process has the potential to function as an effective tool for addressing tax controversies (and welcomes the addition to Section B in Chapter II of the Transfer Pricing Guidelines), in our experience access to these is very limited in developing countries which may lack both the extensive treaty network and the resources to make effective use of them. As a result, taxpayers sometimes have to accept a higher risk of double taxation as a practical consequence on their investment in developing countries. The potential value of this paper in helping to establish a cross-border consensus on commodity transactions is therefore high but so too is the risk of uncertainty if the clarifications and explanations listed above are not made.

7. Summary of Key Points

We welcome the release of the Draft and agree with the OECD that ensuring a consistent transfer pricing approach to commodity-related transactions is important in protecting the consensus built around the arm’s length principle.

Our recommendations summarised in detail in this paper focus on the following aspects:

- Ensuring consistency with the existing consensus around the selection of the most appropriate transfer pricing method to the circumstances of the case;
- Recognition of the value of using taxpayers’ internal comparable data, industry standards, existing guidance and the practical experience gained by taxpayers and tax authorities that have applied the so-called sixth method over the years;
- Recognition that at arm’s length, pricing in commodity-related transactions is likely to result in a range of outcomes, rather than a single pricing point;
- Clarifying the scope and the applicability of the guidance, in particular with respect to the use of the deemed pricing date.

The language of some of the suggestions in the Draft in the areas listed above may require further clarification; but, once this is addressed, we believe the revised paper will assist taxpayers in ensuring their transfer pricing remains arm’s length and will address concerns tax authorities have raised about the potential for the erosion of their tax base in this area.

***
On behalf of the international network of PwC Member Firms, with the contribution of our colleagues Szymon Wlazlowski, Jose Maria Segura, Dale Bond, Jonas Van de Guch, Kathryn O’Brien, Aamer Rafiq, Andrew Casley and Juan Carlos Ferreiro, we respectfully submit our response to the Public Discussion Draft on BEPS Action 10: *Discussion Draft on the Transfer Pricing Aspects of Cross-border Commodity Transactions*. For any clarification of this response, please contact the undersigned or any of the contacts below.

Yours faithfully,

Isabel Verlinden  
Partner  
PricewaterhouseCoopers, Brussels

Adam M. Katz  
Partner  
PricewaterhouseCoopers LLP, New York

cc Stef van Weeghel, Global Tax Policy Leader

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STSA's comments on Public Discussion Draft on BEPS Action 10: transfer pricing aspects of cross-border commodity transactions

Geneva, 5 February 2014
STSA - the Swiss Trading and Shipping Association - welcomes the opportunity to provide comments on the OECD Public Discussion Draft on BEPS Action 10: transfer pricing of cross-border commodity transactions.

About STSA

STSA, the Swiss Trading and Shipping Association, is the nationwide professional association for the commodity trading and shipping industry in Switzerland. It unites under its roof the three regional industry associations GTSA (Geneva Trading and Shipping Association), ZCA (Zug Commodity Association) and LCTA (Lugano Commodity Trading Association).

STSA’s membership base counts more than 160 enterprises based in Switzerland and spans the entire range from SMEs to MNCs. Among STSA’s members are the Swiss-based market leaders of commodity trading, shipping, inspection and classification, trade-financing banks and related service providers. This industry contributes 3.5% of Switzerland’s annual GDP, employs more than 12,000 people directly, and another 26,000 people indirectly. This makes this industry one of the main economic sectors in Switzerland.

Based on its professional expertise, STSA is also highly committed to expanding quality education and training in the field of commodity trading. To this end, STSA operates an increasing number of training programmes, on its own or in partnership with the University of Geneva, that range from short overview courses to a full-scale two-year Master programme and to customized bespoke courses for STSA members.
Comments on Part A

The comparable uncontrolled price (CUP) method and quoted prices (paras. 8 – 12)

STSA agrees that CUP is usually the most appropriate transfer pricing method (para. 8), but only if it allows for adjustments to capture the characteristics of individual commodity transactions and the resulting price differentials (para. 16).

That said, there are circumstances and situations in commodity trading where other transfer pricing methods can be applied with equally faithful and reliable results.

Any transfer price assessment must therefore be based on the characteristics of individual and actual transactions, and not simply on a single marker like a “quoted price” (paras. 9 and 10) or on abstract norms like the “deemed pricing date” (para. 14).

This is to say that for determining a CUP, adjustments or differentials must be possible because of the large and complex variation along multiple dimensions which individual commodity transactions exhibit.

Commodity trading is often the subject of controversy, yet widely misunderstood, and often compared to financial services. When the details of the business are considered in detail, however, the differences and complexities of this business emerge, as do the various uncertainties with which it is beset by its very nature.

If prices for individual commodity trading transactions are usually fixed by initial reference to prices that are quoted on well-developed commodity exchanges, these “quoted prices” are neither equivalent nor even closely linked to the ultimate commodity prices negotiated between the counterparties of any given transaction. This is due to a complex multitude of factors, specific to each individual transaction, which enter into the determination of the final price and can account for substantial price differentials.

These factors vary widely between individual transactions and are typically a combination of the following:

- Quality grade of the commodity
- Size of the shipment (e.g. bulk sales could warrant a discount, small lots a premium)
- Geographical factors: a commodity’s place of origin and delivery and its transport path
- Shipping terms, insurance terms and place of title transfer (usually as per Incoterms\(^1\))
- Financing terms of buyer, shipper and seller
- Global or specific hedging aspects of transactions (for currency risk, price risk etc.)
- Legal requirements, depending on the various countries involved
- Timing of each event on the supply chain (purchase, pricing, resale, etc.)

Another cause of variation and uncertainty is the fact that commodities transactions often span long periods of time, sometimes several months or even years, and the ultimate price of the transaction agreed between the parties may vary throughout this entire contract period.

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\(^1\) The Incoterms rules or International Commercial Terms are a series of pre-defined commercial terms published by the International Chamber of Commerce (ICC). They are widely used in international commercial transactions or procurement processes.
All of these differentials are embedded into the final price of any given transaction, and there is no itemized breakout of what differentials increase the sales price relative to market and which differentials decrease the sales price.

For example, a commodity transaction usually involves considerable but highly variable transport costs, insurance premiums, financing expenses and inspection costs as well as cost differentials arising from the timeline of the operations undertaken for a particular transaction. All these different dimensions entail adjustments of the final price as compared to the initial benchmark price quoted on an exchange, which is therefore only one ingredient among many.

This entails, contrary to paras. 9 and 10, that there cannot be any general transfer pricing rule for commodity transactions based on quoted prices alone. Consequently, the below assertion in para. 10 should be rejected, namely the idea that a CUP equivalent could be arrived at if

“taxpayers and tax administrations [...] take as a reference the standard specifications, on which the price of the commodity is based, used in commodity markets and by price setting agencies” (para. 10)

For the reasons explained above, these quoted “market prices” have ultimately very little to do with the many specificities of individual transactions that in the end determine their ultimate negotiated price. To arrive at a reliable transfer price assessment, a close analysis of the specificities of any given actual transaction is necessary instead.

An illustrative example of the possible range of such complex variation is offered by the distribution of risks and costs between buyers and sellers according to a given transaction’s Incoterms, as summarized in the chart overleaf. These terms govern transport alone, yet can easily account for considerable price differentials according to which side has what risk and cost at which time. The same variation is introduced by all the other aspects of pricing a transaction, as mentioned above.

This variation implies - contrary to paras. 11 and 12.3 - that one commodity transaction is practically never comparable to another, and that transfer pricing must therefore be assessed by an analysis of actual individual transactions.
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Comments on Part B: deemed pricing dates for commodity transactions (paras. 13 - 15)

STSA disagrees with the idea that using one market price on one particular date – the “deemed pricing date” (para. 14) – for determining the CUP would lead to a fairer assessment of arm’s length transfer prices than would a close inspection of individual actual transactions. A general rule like “quoted prices” (above) or the “deemed pricing date” (para. 14) will instead lead to erroneous and therefore easily contestable results.

As explained above, quoted prices or pricing dates or time periods are but some among many ingredients of a final commodity transaction’s price. This implies that a fair assessment of transfer prices by tax authorities specifically requires analyzing individual actual transactions.

The planned guidance cited in para. 15 should therefore not be retained and be replaced with one based on the analysis of individual transactions.

Tax authorities should not have the possibility to set transfer prices retroactively and without regard to the individual transactions that actually took place. Our industry by its nature faces a lot of uncertainties, and all approaches by tax authorities to retroactively assess transfer prices of commodity transactions could restrict the development of trade and particularly the economic activity of developing countries. Such context-free and arbitrary transfer pricing assessments would also damage competition in the – very competitive – commodity markets.

Relatedly, as regards the “reliable evidence” for actual transactions (para. 15), tax authorities should accept that evidence of an actual transaction can be provided in many different ways.

Typical such evidence are documents like order receipts, the conduct of the parties (in line with their functional and risk profiles), transaction proposals and acceptances exchanged via e-mail, transport documentation, customs documentation showing the contract date, and so on.

The cost to enterprises for proving the fairness of each transaction price themselves would be prohibitive. Preparing documentation that supports the reference prices and the adjustments to quoted prices can be an extensive and time-consuming exercise to which enterprises would have to dedicate substantial additional resources. It would also be discriminatory if such a requirement were to be made only of commodity trading - the commodities industry should not be subject to more stringent standards than other industries for transfer pricing documentation purposes.
Comments on section C: comparability adjustments to quoted prices (para. 16 - 17)

STSA agrees that adjustments for comparability of price differentials must be possible (para. 16), but only to account for the multitude of factors determining individual transaction prices.

These have been as explained above, and adjustments for price differentials should therefore not be in the form of schematic reference to “quoted prices” or “deemed pricing dates” alone.

To this end, and in reference to para. 17, the commodity trading industry and specifically our association STSA stand ready to support tax authorities.

The industry is ready to help foster a better understanding of the complexities of our activities and that of the actual transactions it carries out, as well as its pricing mechanisms – all this in order to enable transfer price assessments that are based on actual commodity transactions.

Other comments

While no mention is made of them in the Discussion Draft, STSA would like to underline two other aspects of assessing transfer pricing:

**Minimum taxes:** In an effort to increase tax revenues, many jurisdictions have implemented minimum tax payments, generally as a percentage of gross revenues (often around 1%). Hence they are already legislating against BEPS by imposing a tax that has no reference to the nature of actual transactions or actual value creation. While STSA does not necessarily recommend minimum taxes, they do provide simplicity for both the tax payer and tax authority and give greater certainty when operating in more unpredictable or less developed tax environments.

**Minimum export prices:** Similar to a “deemed pricing date”, some jurisdictions already impose a minimum export price prior to shipment, regardless of the timing, pricing or other aspects of the transaction. Commodity boards or the local government set a minimum export price - generally the prevailing market price on the date of export – thus leading to double taxation if the commodity's price appreciates between contract and export date. It would be useful if the OECD guidance addressed this issue to try and eliminate these practices.
Dear Mr. Hickman,

RE: Taxand responds to OECD invitation for public comments on discussion draft on Action 10: Transfer pricing aspects of cross-border commodity transactions

Further to the publication of the OECD’s invitation for public comments on the discussion draft on Action 10 (other high risk transactions) and the transfer pricing aspects of cross-border commodity transactions, Taxand is honoured to provide written comments based on the practical experience we have as tax advisors.

Protecting the tax base of commodity dependent countries through ensuring that the transfer pricing outcomes of commodity transactions reflects value creation is in line with the objectives of the BEPS Action Plan, which we support.

We would like to salute the efforts of the OECD Committee of Fiscal Affairs for its continual and vast work on laying down the cornerstones for the ambitious and comprehensive Action Plan aimed at addressing base erosion and profit shifting in an open format that allows all stakeholders to provide their views.

Taxand can confirm that we have no objections with posting the comments on the OECD website and that these comments are based on our experience working with multinationals worldwide.

We appreciate this opportunity to provide comments to the OECD Committee of Fiscal Affairs and Working Party No. 6 on the Taxation of Multinational Enterprises and would be pleased to discuss this further and to participate in any further discussion on these matters.

More information about Taxand is provided below. Taxand is wholly committed to supporting the OECD Committee of Fiscal Affairs and Working Party No. 6 on the Taxation of Multinational Enterprises and we look forward to contributing to further debate.

If you wish to discuss any of the points raised in this letter, please do not hesitate to get in touch with us directly via the contact details below.

Yours faithfully,

Taxand

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ABOUT TAXAND

Taxand provides high quality, integrated tax advice worldwide. Our tax professionals, more than 400 tax partners and over 2,000 tax advisors in nearly 50 countries - grasp both the fine points of tax and the broader strategic implications, helping you mitigate risk, manage your tax burden and drive the performance of your business.

We're passionate about tax. We collaborate and share knowledge, capitalising on our expertise to provide you with high quality, tailored advice that helps relieve the pressures associated with making complex tax decisions.

We're also independent—ensuring that you adhere both to best practice and to tax law and that we remain free from time-consuming audit-based conflict checks. This enables us to deliver practical advice, responsively.

Taxand has achieved worldwide market recognition. Taxand ranked in the top tier in Chambers Global Guide 2014 global network rankings and in the International Tax Review's (ITR) World Tax 2015. 41 Taxand locations were commended and a further 26 locations listed in ITR’s World Transfer Pricing Guide 2015. 31 countries were voted top in the ITR Transaction Tax Survey 2014 and 29 in ITR Tax Planning Survey 2013. Taxand has received 65 national awards and 14 regional awards in the ITR European, Americas and Asia Tax Awards since 2009. These include Latin America Tax Disputes Firm of the Year, European TP Firm of the Year, European Indirect Tax Firm of the Year, Asia Transfer Pricing Firm of the Year, and Asia Tax Policy Firm of the Year. Full details of awards can be viewed at www.taxand.com/about-us

www.taxand.com
Taxand would like to thank the OECD for the opportunity to respectfully provide the following comments to the discussion draft on Action 10 on other high risk transactions, regarding the transfer pricing aspects of cross-border commodity transactions.

We have structured our comments according to the three sections of proposed additions to Chapter II of the OECD Transfer Pricing Guidelines as set out in Part II of the Public Discussion Draft:

A. The use of the comparable uncontrolled price ("CUP") method for pricing commodity transactions and the use of quoted prices in applying the CUP method;
B. Deemed pricing date for commodity transactions; and
C. Potential additional guidance on comparability adjustments to the quoted price.

1. Comments on the use of the CUP method for pricing commodity transactions and the use of quoted prices in applying the CUP method

Taxand agrees that the CUP method can be an appropriate transfer pricing method for establishing the arm’s length price between associated enterprises for the transfer of commodities for which a quoted or public price is available, subject to the conditions of the controlled transaction and the conditions of the quoted prices being comparable.

In this regard, in applying the CUP method, the general comparability factors such as the characteristics of the property or services transferred, the functions performed by the parties, the contractual terms, the economic circumstances of the parties and the business strategies pursued by the parties should be considered. In the context of cross-border commodity transactions, we are of the view that the impact on price comparability of, in particular, long term supply agreements and/or offtake agreements, the transfer of ownership, the impact of government incentives and/or subsidies as well as the value of marketing activities performed by the acquirer should also be taken into account.

*Long term and/or offtake agreements*

Offtake agreements are frequently used in natural resource development, where the capital costs to extract the resource are significant and the company wants a guarantee that some of its product will be sold. Such agreements are particularly prevalent, where the construction of the mine or production facility requires upfront external funding.

Third parties entering into such an offtake agreement would generally agree to discounts on the quoted price for the commodity product(s) in question for the acquirer, taking into account that the acquirer’s undertaking to acquire all or a certain portion of the production of the mine or production facility effectively allows for the construction of the mine or production facility to be financed.

Similarly, we have seen a number of long-term supply agreements entered into between the producer (either by the mine directly or via an affiliated marketing or distribution entity) and its customers, where adjustments to the quoted price for the commodity product in question were included in the pricing mechanism. Depending on the nature of
the commodity product in question and the relative bargaining position of the parties involved, such a pricing adjustment involved either the application of a discount or a price premium to the quoted price. Discounts are often seen in the context of long-term supply agreements where there is no constant and stable demand for the specific commodity. It is therefore of strategic importance for the producer to build a market for its commodity products that allows for the recovery of the substantial capital investment typically required in the natural resources extraction industry (including a risk related return for the investors). On the other hand, price premiums are often seen in the context of long-term supply agreements where customers are trying to secure a steady supply of a scarce commodity.

Such discounts and/or price premiums may increase and/or decrease over the period of a long term contract, contributing to further complexity in making comparability adjustments. In order to provide clarity as to the approach in respect of the impact on the application of the CUP method of such discounts and/or price premiums, further guidance would be welcomed.

Transfer of ownership

Companies trading in commodities are subject to a variety of risks that are best characterised as “operational”, in the sense that these risks result from the failure of some operational process, rather than from variations in prices or quantities. One such risk is the transportation of commodities, generally by sea. The owner of the commodity will generally carry the risk of any delays in delivery or of any loss or damage to the commodity whilst in transit, which may result in financial penalties or losses.

In addition, the owner of the commodity generally also carries the logistic and environmental risks.

Environmental risks associated with transportation and storage are a particularly acute concern to the owners of the commodity due to the potentially large liability costs that a spill or other accident can cause.

The financial consequences of some of these risks can however be transferred via insurance, which policies insure against, inter alia, product liability, bodily injury and pollution.

Other risks, however, cannot be insured and the owners of the commodity must put policies and procedures in place to mitigate, for example, theft and contamination risks.

The point at which ownership of the commodity changes from the seller to the buyer therefore determines who will be responsible for the risks associated with owning the commodities while being transported and this will determine which party is responsible for the costs associated with these risks.

The extent of the financial implications of being the owner of the commodity could have a severe impact on the profits of the seller and thus materially affect the price of the
commodity transaction and should therefore be taken into account when considering comparability adjustments to the quoted price. Further guidance in this regard would be welcomed in order to establish a consistent approach to the treatment of the transfer of risk.

Government incentives and/or subsidies

Another factor that could impact the reliable application of the CUP method, is government incentives and/or subsidies. Such incentives and/or subsidies can take various forms and the allocation of these benefits could potentially materially impact the price agreed in a commodity transaction and should therefore be taken into account when considering comparability adjustments to the quoted price. We recommend that further guidance and/or examples in this regard be included in the Discussion Document.

Value of marketing activities

Taxand supports the OECD’s view at paragraph 7 that “development and implementation of transfer pricing rules which do not take into account the economic context, industry and business model in which associated enterprises operate and transact with one another may lead to arbitrary and unrealistic results and with that may lead to double taxation or double non-taxation hindering cross-border trade and investment”.

Accordingly, in our view, in the context of the commodities industry the role of marketing activities should also be considered.

In particular, the value of marketing activities in the commodities industry often lies in the development of new markets, which also involves research and development in order to identify and develop new uses for certain classes of commodities, securing long term supply contracts and maintaining the relationship with customers in this regard.

For example, considering the substantial amount of capital that is required to develop infrastructure for the extraction or refining of commodities, such as platinum group metals (“PGMs”), it is of strategic importance for any mine/producer to have confidence about the future of the potential market for the relevant commodity class. Accordingly, market development, including activities to ensure that a sustainable and profitable market for the commodity class in question exists in the medium to long-term future, is of significant value to the mine/producer.

In addition, due to the strategic importance of long term and/or offtake agreements, focusing on maintaining and developing customer relationships and renegotiating long term contracts on a regular basis, including, for example, balancing varying supplies with varying demand, constitutes an important strategic marketing activity.

The value of these marketing activities could materially affect the price of the commodity transaction being examined and should therefore be taken into account when considering comparability adjustments to the quoted price. We recommend that further guidance and/or examples in this regard be included in the Discussion Document.
Impact on transfer pricing documentation

Further guidance in respect of the level of detail required to be disclosed in respect of confidential pricing arrangements when documenting the price-setting policy for commodity transactions would be welcomed by taxpayers.

2. Comments on the proposed deemed pricing date for commodity transactions

Taxand agrees with the proposed approach of the OECD whereby a deemed pricing date will only become relevant in the absence of reliable evidence of the actual pricing date agreed by the associated enterprises. Taxand further understands the suggested use of the date of shipment as evidenced by the bill of lading or equivalent document, as these documents are likely to be easily obtainable.

However, considering that commodity transactions often involve physical delivery at a future date and taking into account that there could be a significant period of time between the date on which the contract is entered into and the date on which delivery takes place as well as considering the potential price volatility in commodities markets, Taxand is concerned that using the date of shipment as the deemed pricing date may not necessarily reflect the complexity and risk of pricing in the commodity industry. In Taxand’s view, such an approach also does not take into account the particular risk appetites of the parties to the transaction.

Taking into account that the parties to the transaction would have had access to certain pricing information and accordingly have a certain pricing date in mind at the time of entering into the commodity transaction, it might be more appropriate to establish a deemed pricing date with reference to publicly available information at the time of entering into the commodity transaction. Alternatively, an average price could be determined.

In addition, considering the variety of commodity classes and the different markets in which each class is traded, using the date of shipment as the deemed pricing date across all classes of commodities may not be appropriate. It should be considered whether certain classes of commodities should be excluded from the application of the proposed deemed pricing date, for example energy commodities such as electricity.

Action 9 on risk and capital

The OECD has advised that transfer pricing work being undertaken under, *inter alia*, BEPS Action 9 on risk and capital is also relevant to commodity transactions and should help in ensuring that transfer pricing outcomes in commodity transactions are in line with value creation. In this context, associated entities may contractually agree to transfer, for example, the pricing risk, in a commodity transaction and using the date of shipment as the deemed pricing date may expose an entity to a risk that is not aligned to its general risk profile since the pricing risk is managed by another associated entity within the multinational enterprise.
Use of mutual agreement process

Furthermore, with regards to resolving cases of double taxation arising from the application of the deemed pricing date through the mutual agreement process, please also refer to our comments in respect of the OECD discussion draft on Action 14 (make dispute resolution mechanisms more effective) and the practical suggestions for improving the resolution of treaty-based tax disputes under Mutual Agreement Procedures, which can be accessed here.

3. Comments on potential additional guidance on comparability adjustments to the quoted price

Taxand acknowledges that one of the objectives of this public consultation process is to obtain input on practical examples in respect of comparability adjustments to quoted prices in the context of commodity transactions. In this regard, we have raised the potential impact on prices agreed between independent enterprises of, in particular, long term supply agreements and/or offtake agreements, the transfer of ownership, the impact of government incentives and/or subsidies as well as the value of marketing activities performed in the context of commodity transactions.

Further guidance and/or examples indicating the proposed treatment by the OECD would be of particular importance to enable taxpayers to apply the CUP method using quoted prices and industry standard adjustments [Drafting note: any examples of industry standard pricing adjustments would be welcome].

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We appreciate this opportunity to provide comments to the OECD Committee of Fiscal Affairs and Working Party No. 6 on the Taxation of Multinational Enterprises and would be pleased to discuss this further, and to participate in any further discussion on these matters.

More information on how to contact Taxand is provided above. Taxand is wholly committed to supporting the OECD Committee of Fiscal Affairs and Working Party No. 6 on the Taxation of Multinational Enterprises and we look forward to contributing to further debate.

Yours faithfully,
Taxand

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3 February 2015

Andrew Hickman
Head, Transfer Pricing Unit
Centre for Tax Policy and Administration
Organisation for Economic Co-Operation and Development
Paris, France

Via Email: transferpricing@oecd.org

RE: Public Discussion Draft on BEPS Action 10: Commodity Transactions

Dear Mr. Hickman:

On 19 July 2013, the OECD published an Action Plan on Base Erosion and Profit Shifting (hereinafter the Action Plan or the Plan) setting forth 15 actions the OECD will undertake to address a series of issues that contribute to the perception that individual countries’ tax bases are being eroded or profits shifted improperly. Pursuant to Action 10 of the Plan, on 16 December 2014 the OECD published a document entitled BEPS Action 10: Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions (hereinafter the Discussion Draft or Draft).

The OECD solicited comments from interested parties no later than 6 February 2015. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the OECD’s request for comments.

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organisation has 56 chapters in Europe, North and South America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws,
at all levels of government. Our nearly 7,000 individual members represent over 3,000 of the largest companies in the world.¹

**TEI Comments**

TEI commends the OECD for its work on the application of the arm’s length principle to cross-border commodity transactions in the Discussion Draft. The guidance proposed in the Draft is a step in the right direction and relatively non-controversial. The recommendation to use publicly available quoted exchange prices as a comparable is particularly welcome. The Discussion Draft sets forth several issues with respect to cross-border commodity transactions as identified by tax authorities. These include the advantageous use of pricing conventions, significant taxpayer adjustments to the quoted commodity price, and the involvement of limited function entities in low tax jurisdictions. TEI agrees that these issues should be addressed and the approach in the Draft is a good starting point. The Discussion Draft, however, omits other issues that, if neglected, may unnecessarily complicate the application of the new guidance.

**Pricing Issues**

First, the Discussion Draft does not address the difference between commodities for which actual trading prices are quoted on an exchange – such as the London Metals Exchange or Chicago Board of Trade – and other commodities (bulk traded goods) for which market price indicators are available through pricing agencies – such as Argus or Bloomberg. If a price for a commodity is quoted on one of the various exchanges then a person willing to sell such a commodity has a guaranteed opportunity to sell the goods for the quoted price. In contrast, the prices for bulk traded goods are only available by indirect indications and a person willing to sell the product does not have a guaranteed opportunity to sell the goods for the indicated price. The Discussion Draft conflates these two very different situations without carefully delineating between them and addressing how the arm’s length principle may apply in each case.

Market price indicators with respect to bulk traded goods do not reflect the prices of such goods precisely enough to use as a comparable for transfer pricing purposes. They are derived by various direct and indirect means and do not necessarily “generally reflect the agreement between independent buyers and sellers in the market on the price for a specific type and amount of commodity” – as the Draft notes with respect to prices quoted on an exchange.² Instead, they may include data and other information from parties not involved in the trades, including but not limited to desired (but not actual) prices advertised by market actors.

¹ TEI is a corporation organised in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).
² Discussion Draft, p.5.
opinions of analysts, etc. The deviation between the price indicators available through pricing agencies and the actual market prices may reach material levels. Thus, while applying the comparable uncontrolled price (CUP) method is appropriate with respect to exchange traded commodities, it may not always be the most reliable transfer pricing method for bulk traded goods where prices are available from a pricing agency.

Another issue with the use of market pricing indicators from pricing agencies is that they usually reflect the prices of “spot” transactions, whereas the majority of bulk traded goods are sold based on contracts with long term commitments. Sellers are typically willing to provide reasonable discounts versus spot prices for such long term commitments, an important pricing factor for these goods. While the Discussion Draft correctly identified several other significant pricing factors, such as specificities of the goods, possible additional processing needed, position in the supply chain, etc., this one was omitted.

Another important pricing factor is the necessity to leave an arm’s length profit margin for the trading and distribution functions of MNEs. The Discussion Draft implicitly recognises this through references to the position of an entity in the supply chain, but it should be specifically mentioned in the final guidance. In addition, the volume of the contract is another factor that often results or requires a pricing adjustment from those terms that may be publicly available. In sum, TEI recommends that the second to last sentence of paragraph 3 of the proposed additions to be included immediately after existing paragraph 2.16 of Chapter II, Section B. of the transfer pricing guidelines specifically reference the volume, duration, and payment terms as factors that affect commodity pricing. Given the volume of most commodity transactions, even a minimal change in pricing to reflect differences in volume, duration or payment terms can result in material tax adjustments.

Neglecting the above issues may trigger oversimplification in the form of assertions by tax authorities that the sales of commodities and bulk traded goods should “normally” be done with the quoted (exchange) prices or (mistakenly) equivalent price quotes from pricing agencies. This would lead to unrealistic price estimation and not to “creat[ing] greater consistency in the way tax administrations and taxpayers determine the pricing or commodities under the arm’s length principle.” To avoid this result, the proposed changes in the OECD guidelines should be re-drafted to reflect business realities of commodity pricing in a more precise manner.

The “Deemed Pricing Date”

The Discussion Draft includes a deemed pricing date proposal for commodity transactions in cases where there is an absence of reliable evidence of the agreed pricing date

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3 Id. at p.6.
4 Id. at p.4.
used for transactions between associated enterprises. The Draft’s proposal uses the quoted price on the shipment date (incorporating any comparability adjustments) as the “pricing date,” which is defined as “the specific date or time period selected (e.g. a specified range of dates over which an average price is determined) by the parties to determine the price for the commodity transactions.” The shipping date may generally be a relevant date for commodities commonly priced at the shipping date, but this is not the case for all commodities and thus the recommendation is too specific and limited.

The goal of a deemed pricing date is to remove the taxpayer’s ability to selectively manipulate and choose prices to its sole advantage. The recommendation should begin with a statement of principles for picking the deemed pricing date based upon objective, uniformly applied criteria that are consistent with third party pricing conventions for the type of commodity transaction. This would remove the possibility that the parties will selectively choose the most advantageous price on a transaction by transaction basis. The guidance should then reference several possibilities. These should include the average price for the period of the transaction, or specific transaction dates such as date of shipment, date of receipt or date of delivery, whichever is most appropriate with the form of transaction and industry practices. All of these methods remove the ability of the taxpayer to manipulate transfer prices and give both the taxpayer and the tax authorities the flexibility to choose the method that is most appropriate to the actual transaction. The adoption of a single default method is too rigid an approach for the variety of commodities that are traded today.

Documentation Issues

The documentation requirements of a price-setting policy in the case of commodities that are traded at a quoted price, which would implicate the CUP arm’s length price, is an important element to be taken into account by tax authorities while performing their transfer pricing evaluations and risks assessments. The Discussion Draft states that taxpayers should include their price-setting policy in their transfer pricing documentation. However, the Draft does not specify the proper place for such documentation in the context of the tiered approach developed under BEPS Action 13. In TEI’s view, for countries and MNEs that adopt the tiered approach to documentation under Action 13, the master file is the appropriate place to document an MNE’s commodity pricing policy. Such a policy is relevant to providing a high-level overview of an MNE’s operations. In fact, including documentation of price-setting mechanisms and application of the CUP method in the case of commodities that are traded at a quoted price in the master file would simplify transfer pricing documentation and would be welcomed by MNEs that regularly produce, purchase, sell, or deal in commodities.

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5 Id. at p.6.
Conclusion

TEI appreciates the opportunity to comment on the OECD Discussion Draft under BEPS Action 10 addressing transfer pricing issues for cross-border commodity transactions. These comments were prepared under the aegis of TEI’s European Direct Tax Committee, whose Chair is Nick Hasenoehrl. If you have any questions about the submission, please contact Mr. Hasenoehrl at +41 786 88 3772, nickhasen@sbcglobal.net, or Benjamin R. Shreck of the Institute’s legal staff, at +1 202 638 5601, bshreck@tei.org.

Sincerely yours,
TAX EXECUTIVES INSTITUTE, INC.

Mark C. Silbiger
International President
Lima, February 06, 2015

To
Mr. Andrew Hickman
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration
Organization for Economic Cooperation and Development (OECD)


Dear Sir,

Z & A welcomes the opportunity to provide comments on the OECD’s Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions.

We support the recognition by the OECD, that difficulties in determining prices is a serious problem for commodity dependent developing countries; however, this is also the case for companies involved in commodities exports.

Although we agree in principle with the proposals, we are concerned that the Discussion Draft does not add guidance on the cases where the country exports “concentrates of metals” instead of metals. In the following pages we would like to offer our point of view about the paragraphs proposed to be inserted in the Transfer Pricing Guidelines.

We hope that you find our comments useful. We look forward to participating in the public consultation to be held on 19-20 March 2015, and would also be happy to help in any other way that we can.

Yours sincerely

Fernando Zuzunaga Del Pino
Partner
Zuzunaga, Assereto & Zegarra Abogados

Renée Antonieta Villagra Cayamana
Partner
Zuzunaga, Assereto & Zegarra Abogados
<table>
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<th>Public Discussion Draft</th>
<th>Z &amp; A comments:</th>
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<tbody>
<tr>
<td>1. The CUP method can be an appropriate transfer pricing method for establishing the arm’s length price for the transfer between associated enterprises of commodities for which a quoted or public price is available (&quot;quoted price&quot;), subject to the conditions of the controlled transaction and the conditions of the quoted prices being comparable. The reference to &quot;commodities&quot; shall be understood to encompass physical products for which a quoted price is used by independent parties in the industry to set prices in uncontrolled transactions.</td>
<td>This paragraph could not be applicable in cases where the transaction involves the transfer of “concentrates of metals” or “concentrates of minerals” which are not commodities. Quoted prices commodities obtained from London Metal Exchange do not consider the case of “concentrates of metals”; this market is set exclusively for metals. Concentrates of metals do not qualify as metal. The paragraph proposed does not solve the problem for commodity dependent developing countries which export “concentrates of metals” or “concentrates of minerals”.</td>
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<td>2. Under the CUP method, the arm’s length price for commodity transactions may be determined by reference to comparable uncontrolled transactions and by reference to comparable uncontrolled arrangements represented by quoted price of the commodity in the relevant period obtained in an international or domestic commodity exchange market. In this context, a quoted price also includes prices obtained from recognized</td>
<td>This paragraph could not be applicable in cases where the transaction involves the transfer of “concentrates of metals” which are not commodities. Quoted prices commodities obtained from</td>
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and transparent price reporting or statistical agencies, or from governmental price-setting agencies, where such indexes are used by unrelated parties to determine prices in transactions between them. Quoted commodity prices generally reflect the agreement between independent buyers and sellers in the market on the price for a specific type and amount of commodity, traded under specific conditions at a certain point in time. A relevant factor in determining the appropriateness of using the quoted price for a specific commodity is the extent to which the quoted price is widely and routinely used in the ordinary course of business in the industry to negotiate prices for uncontrolled transactions comparable to the controlled transaction. Accordingly, depending on the facts and circumstances of each case, quoted prices can be considered as a reference for pricing commodity transactions between associated enterprises.

London Metal Exchange do not consider the case of “concentrates of metals”; this market is set exclusively for metals. Concentrates of metals do not qualify as metals.

The paragraph proposed does not solve the problem for commodity dependent developing countries which export “concentrates of metals” or “concentrates of minerals”.

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<th>3. For the CUP method to be reliably applied to commodity transactions, the commodity being transferred in the controlled transaction and the commodity in the uncontrolled transactions or in a comparable uncontrolled arrangements represented by the quoted price need to be similar, in terms of the physical features and quality of the commodity. In addition, the contractual terms of the controlled transaction should also be considered such as volumes traded and the timing and terms of delivery. If the quoted price is used as a reference for determining the arm’s length price, the standardized contracts which stipulate specifications on the basis of which commodities are traded in the market and which result in a quoted price for the commodity may be relevant. Where there are differences between the conditions of the controlled transaction and the conditions of the uncontrolled transaction, the quoted price may not be appropriate.</th>
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<tr>
<td>In terms of physical features and quality of the commodity, metals are absolutely different from “concentrates of metals”. Minerals can be commercialized either as concentrates or refined. Refined minerals are directly purchased by industrial enterprises (steelworks, processors, converters, etc.), whereas concentrates minerals are sold by more complex transactions, between the mining companies, traders, refineries and smelters for further transformation to metal. It is called concentrated minerals, in the mining activity, the product rich in metals. The concentrates are obtained by various methods such as flotation, gravity, magnetic separation, etc., and they are typically higher in metal content than the concentrates.</td>
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determining the quoted price for the commodity that materially affect the price of the commodity transactions being examined, reasonably accurate adjustments should be made to ensure that the economically relevant characteristics of the transactions are sufficiently similar. Such differences can be related, for instance, to different specificities of the commodity (e.g. premiums for quality or availability of the commodity), different processing functions performed or required, or additional costs incurred for transportation, insurance or foreign currency terms. Consideration should also be paid to how unrelated parties use to quoted prices as a reference price and make adjustments to reflect the position in the supply chain of the parties to the transaction.

The concentrates are named by the highest metal content can be concentrated zinc, copper, lead and others. So, can be noted that concentrates containing metal but is accompanied by other elements, besides waste materials.

The content of the concentrates is always different. This can be attributed to the place of origin (because each site has its own particular characteristics) and to the content of the site that is not homogeneous. Therefore, the concentrate will have similar but not identical elements contained, although the case of the same deposit mineral. Each concentrate will have a different degree of concentration and a different value depending on their characteristics.

| processes such as flotation, leaching, gravimetry, among others. |
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| 5. A particularly relevant factor for commodity transactions determined by reference to the quoted price is the pricing date, which refers to the specific date or time period (e.g. a specified range of dates over which an average price is determined) selected by the parties to determine the price for the commodity transactions. Where the taxpayer can provide reliable evidence of the actual pricing date agreed by the associated enterprises in the controlled commodity transaction, tax administration should take the actual pricing date as a reference to determine the price for the commodity transaction. If the pricing date actually agreed by the parties is the date of shipment as evidenced by the bill of lading or equivalent document depending on the means of transport. |
| We do not identify the reason why tax administrations may deem the pricing date for the commodity transaction to be the date of shipment as evidenced by the bill of lading or equivalent document depending on the means of transport. |
| Even in the case of transactions or arrangements celebrated between independent parties they do not agree that |
associated enterprises is inconsistent with other facts of the case, the tax administrations may impute an actual pricing date consistent with the evidence provided by those other facts of the case (taking into consideration industry practices). In the absence of reliable evidence of the actual pricing date agreed by the associated enterprises, tax administrations may deem the pricing date for the commodity transaction to be the date of shipment as evidenced by the bill of lading or equivalent document depending on the means of transport. This would mean that the price for the commodities being transacted would be determined by reference to the quoted price on the shipment date, subject to any appropriate comparability adjustments. Furthermore, it is essential to permit resolution of cases of double taxation arising from application of the deemed pricing date through the mutual agreement process.

the price for the commodities would be determined by reference to the quoted price on the shipment date.