

February 18, 2009

Mr. Jeffrey Owens
OECD Centre for Tax Policy and Administration
2, rue Andre-Pascal
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Dear Mr. Owens:

RE: Consultation on OECD Discussion Draft on Transfer Pricing Aspects of Business Restructurings

The member firms of Deloitte Touche Tohmatsu (hereinafter referred to as “Deloitte”) are pleased to provide the following comments in response to the OECD Committee on Fiscal Affairs’ invitation to comment on business restructuring issues dated 19 September 2008.

The area of business restructurings is key for businesses, and we welcome the OECD’s deliberations in this area. At the present time, the differing views of tax administrations on business restructurings have lead to considerable uncertainty and a high risk of double taxation. We feel strongly that the OECD’s involvement will lead to consensus among tax administrations and result in a better business environment.

To help the process along, we respectfully submit the following comments on the Discussion Draft released on 19 September 2008. The Discussion Draft is a necessarily lengthy document, and to comment on all the issues it raises would lead to an equally lengthy document; for the sake of brevity, we have restricted our comments to major points that might benefit from further analysis.

Deloitte’s comments address those parts of the Discussion Draft that could benefit from greater clarity; however, this should not create the impression that we believe the Discussion Draft is a negative development. To the contrary, the evident desire for balance and restraint in the Discussion Draft is to be applauded. We have not taken every opportunity to indicate where we agree with the sentiments of the Discussion Draft. To do so would have made our response even longer.

Deloitte applauds the OECD’s efforts to provide practical guidance and clarification on the issue of business restructurings. We look forward to the results of this work.



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Introduction

The Discussion Draft states that the arm's length principle and the OECD Transfer Pricing Guidelines ('the Guidelines') should not apply differently to restructurings or post-restructuring transactions than to transactions that were structured as such from the beginning (paragraph 16.) This is a welcome statement.

Influence of the Discussion Draft and next steps

The Discussion Draft will have wide relevance across all transfer pricing, because it interprets the application of the existing Guidelines. These interpretations are likely to be applied outside the context of business restructurings. We understand that the Discussion Draft is meant to interpret the application of the Guidelines in the context of business restructurings, rather than to generally amend or to reinterpret the Guidelines. It is therefore extremely important that the Discussion Draft does not disturb widely held understandings of the existing Guidelines. In reviewing the Discussion Draft, we have paid particular attention to areas in which we think the Discussion Draft extends or conflicts with our understanding of the Guidelines and the way in which they are generally interpreted and applied at present.

Issues Note 2, "Arm's Length Compensation for the Restructuring Itself," does not appear to be strictly an interpretation of the application of the Guidelines. Instead, it extends the logic and general principles in the Guidelines to a class of transactions and events not covered by the Guidelines.

Lack of consensus

Throughout the draft guidance, the following terms are used in describing the positions of OECD members: "some," "several," "most," "large majority," "vast majority." This seems to indicate a lack of consensus on the positions set forth in the Discussion Draft. It would be helpful if one prevailing view could be formed; those countries that wish to disassociate themselves from this view could do so explicitly, as they do in relation to Article 7 and the Commentary thereon.

A practical solution to actual disputes where tax administrations could not agree over re-characterisation would be for an acknowledgement that the status quo - i.e., the transactions entered into by the multinational enterprise (MNE) group - should not be disturbed (except by a pricing adjustment) and that a transaction should not be disregarded by one tax administration alone. This would remove an otherwise almost insurmountable barrier to the elimination of double taxation in those cases.

Decision making in MNEs

We believe the Discussion Draft could more accurately reflect the different decision-making processes within MNEs compared to those available to independent enterprises. Subsidiaries within MNEs do not need to undergo the same decision-making processes for transactions among themselves that are seen between independent enterprises. Independent enterprises have different decision-making processes (and of course options) available to them.

Any evidentiary requirements in the Discussion Draft should recognize that decisions to proceed with business restructurings within MNEs are usually made at the group level, not by individual subsidiaries acting alone. We believe that it would be more useful if tax administrations were to focus on the outcome of what an MNE has done, rather than on the process by which the MNE arrived at that point. Requiring subsidiaries of MNEs to document something they do not otherwise do would be an extension of the Guidelines, and would impose a substantial compliance burden. MNEs should not be required in their internal operations to replicate an approach that would be adopted between independent enterprises.

Move to subjective assessment criteria in the Discussion Draft

The Discussion Draft is permeated by criteria that are often subjective. While we accept that judgement will always play a part in dealing with the transfer pricing aspects of business restructurings, too much reliance on subjective criteria may lead to an excessive compliance burden. We do not advocate an overly formulaic or mechanical approach to how tax administrations look at business restructurings, but an over-reliance on subjective criteria creates more uncertainty, which goes against one of the aims of this exercise. We feel that a greater use of examples would help establish recognisable criteria that could be applied in a more objective manner.

Guidance on how tax administrations should make any adjustments

We believe it would be useful if the OECD could give more thought to precisely how any recommendations within the Discussion Draft should manifest themselves in terms of actual adjustments to the taxpayer's profits. For instance, when should an adjustment focus on a one-off payment related to a contract, as opposed to an ongoing adjustment of prices charged for goods or services provided under the contract?

Issues Note 1: Special considerations for risk

Risk allocation and control: How risk is allocated at arm's length (Section B1)

We feel that elements in this section go beyond what is currently in the Guidelines and are predicated on concepts that do not accurately mirror the arm's length situation between independent enterprises.

We do not believe that determining which party has greater control over a risk is a compelling test in determining which party would be allocated that risk. At arm's length, risk might have to be borne where there is little chance of controlling it.

Furthermore, whether or not a risk *can* be borne through financial capacity is not necessarily a good guide to where that risk is borne.

We agree with the general comment that to control a risk requires some element of decision-making ability to take on the risk, and that managing it can be done through others. However, the conclusion that to control a risk in this context one must be able to assess the outcome of those others' management abilities needs further examination if this is to be a compelling test of who controls or bears a risk. A party might not actually be competent to assess something, however hard it may try. For instance, in the example in [paragraph 32](#), the investor may not have the ability to assess the fund

manager's own ability. But the investor still carries the risk, whether or not he is actually controlling it.

A tax administration's ability to adjust risk allocations (Section B2)

We feel that some parts of this analysis will be interpreted in a way that changes what is in the current Guidelines. This is of concern, especially as the issue note says that its conclusions have ramifications for transfer pricing issues outside business restructuring.

In the example in paragraph 37, recharacterisation would not be appropriate, given that the arm's length situation in the example can be arrived at through a pricing adjustment. When there are differences in the conditions of the comparable transaction and the tested transaction (for instance, different risk allocations), the arm's length price can be determined by starting with the price for a comparable transaction and adjusting this price for the differences in the conditions. The result would be an arm's length price for a transaction with non-arm's length conditions – something that is explicitly allowed under the Guidelines.

In the example in paragraph 38, first bullet point, the parties' behaviour conforms to the contract. The behaviour has economic substance. Evidence has been found that indicates that unrelated parties allocate risk differently. But an adjustment can be calculated based on the price charged to unrelated parties using the principles in paragraphs 1.25-1.27 of the Guidelines. In these circumstances, a recharacterisation would not be permitted under paragraphs 1.36-1.41. Paragraphs 1.25-1.27 are correctly utilised to resolve a comparability issue.

In the second bullet in paragraph 38, the distributors have relatively more control over excess inventory risk because they make decisions concerning purchase quantities. It is stated that "the tax administration may re-assign the consequences from the risk allocation...following the guidance at 1.25-1.27." Paragraphs 1.25-1.27 are being used to change the risk allocation that was agreed between the parties.

It is our understanding that the Guidelines do not permit a tax administration to change the conditions of the company's transactions, such as reassigning risk, other than when allowed to by paragraphs 1.36 to 1.41. This new example is misleading, because it could be read as suggesting that risk can be reallocated by the tax administration without consideration of Paragraphs 1.36-1.41. We believe that any difference to an arm's length risk allocation would currently be given effect to with a pricing adjustment.

Paragraph 39 attempts to reconcile this with the current position under the Guidelines, but unfortunately introduces a new concept to do this – the "core element" of a transaction. We are concerned that this may allow some tax administrations to reallocate risk – or change other terms of a taxpayer's transactions – without being limited by paragraphs 1.36-1.41 if they take the position that they are not challenging the core element of a transaction. It could be open to tax administrations to go as far as assessing a limited-risk distributor as a fully fledged distributor by reallocating risk and claiming that they are not challenging the core element of the transaction, because they are not disturbing the overall buy/sell relationship between manufacturer and distributor.

The second bullet point in paragraph 38 should be deleted, and in any case the use of the phrases "core element" and "re-assign the consequences from the risk allocation" should be reconsidered. It should be made clear that this must be a pricing matter. We do not believe that paragraphs 1.25-1.27 of the

Guidelines require risk to be allocated as it would be between third parties. Instead, those paragraphs require that differences in the conditions be taken into account in pricing the taxpayer's actual transactions. Paragraphs 1.36 to 1.41 are the only part of the Guidelines that allow an adjustment to the transactions actually undertaken, and then only under the strict conditions set out in those paragraphs.

An example of what all this may mean in practice may be helpful. Under the Guidelines, a tax administration can adjust the price of transactions that occur under an ongoing buy/sell distribution agreement to reflect the fact that the distribution agreement between affiliates contains a requirement for the manufacturer to buy back unsold inventory, whereas comparable arm's length agreements have no such requirements. Under the Discussion Draft it seems that the tax administration can "challenge" the obligation to repurchase: we presume that such a challenge could consist of disregarding the transaction but without having regard to paragraphs 1.36 – 1.41 of the Guidelines. This seems to us to amount to disregarding the transactions actually undertaken which should be governed by paragraphs 1.36 to 1.41.

From the perspective of the business community, the proposed extension of the circumstances in which a tax administration could 'challenge' the transactions actually undertaken – and price on some different basis – has some major disadvantages. The principal objections are (i) the increased uncertainty regarding the tax position of the group, (ii) the heightened risk of double taxation arising from disagreement between tax authorities about how to adjust the transactions (or indeed whether to do so at all), and (iii) the added compliance burden of having to search for evidence regarding whether or not third parties adopt all of the conditions that the group wishes in its internal arrangements.

Significant risk (Section C) and the transfer pricing consequences of a risk allocation (Section D)

Regarding paragraph 45, we think that a contractual allocation of risk can create a low-risk environment. It therefore follows that a transfer pricing method that reflects the contractual allocation of risks is appropriate in that low-risk environment.

Issue Note 2: Arm's length compensation for the restructuring itself

Will the Guidelines now apply to changes in commercial arrangements?

The title for this issue note could be misleading, because it gives the impression that the actual restructuring itself requires compensation at arm's length. It is the elements within the restructuring that might or might not attract compensation at arm's length, not the event itself.

Paragraph 46 proceeds on the assumption that the Guidelines apply to changes in commercial relationships between related parties. This seems to be an extension of the Guidelines to a wide new range of events. The Guidelines price transfers of goods, services, and intangibles between related parties. In particular, they contain rules for pricing these transfers based on either exact arm's length comparables or by adjusting inexact arm's length comparables for differences in the conditions surrounding the transactions. The latter is recognised as necessary because the Guidelines do not require identity of conditions between related-party and arm's length transactions (subject to limited scope for non recognition). Changes in the commercial relationships between related parties are not explicitly within the scope of the Guidelines.

Paragraph 11 of the Guidelines states:

“In applying the foregoing principles to the taxation of MNEs, one of the most difficult issues that has arisen is the establishment for tax purposes of appropriate transfer prices. *Transfer prices are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises.*” (Emphasis added.)

No mention is made of changes in commercial arrangements. Is it the OECD’s intention to use the Discussion Draft to extend the scope of the Guidelines to a wide range of new events?

The Discussion Draft proceeds on the basis that the termination of existing arrangements should be governed by the arm’s length principle. However, the Discussion Draft does not consider the interaction of possible compensation on termination with the pricing of transactions conducted under the terms of the agreement. The comparability sections of the Guidelines require consideration of the terms and conditions of the transactions to determine an arm’s length price. This includes the allocation of risks under the agreement and the termination provisions. For example, it is reasonable to expect that a licensee would pay a lower royalty if the agreement allowed termination of the licence on short notice. Under the Guidelines, this could lead to a comparability adjustment in determining the arm’s length royalty. That should be the end of the matter. The taxpayer should not also be required to pay or receive compensation on termination or expiry of the agreement, other than to the extent that arm’s length parties would have provided for such compensation in the same circumstances. Compensation should not be required in relation to non-arm’s length conditions in the agreement as these should be dealt with as comparability issues in determining arm’s length prices under the agreement.

Compensation for functions transferred

According to the Discussion Draft, business restructurings involve a transfer of functions, assets, and/or risks. Our understanding of sections B and C is that compensation might be required only from a reallocation of risks, rights, or other assets, or something else of value. It is not clear from the Discussion Draft how the term functions should be interpreted in this context. Could the OECD clarify its view on compensation for the transfer of functions, or otherwise make it clear that compensation is only in point for the transfer of rights and other property? We believe functions are not transferred – rather, one function ceases and another one starts somewhere else.

Identifying the restructuring transactions: What rights actually exist? (Section A1)

We feel that parts of the approach in paragraphs 49-50 are useful: it is necessary to identify the transactions in any analysis, because otherwise there is nothing to price. For compensation to be due at arm’s length, something of value or presumed value must have been transferred. We feel that the conduct of the parties is only a guide. Greater rights can be said to exist only to the extent that legally enforceable rights would exist at arm’s length.

It would be wrong to characterise a long-standing ‘at will’ relationship as generally giving rise to rights that need to be recognised, as suggested by Paragraph 51. The reference to compensation being due to one party for ‘developing its market without explicit compensation’ is unlikely to apply between independent parties. Nor would the fact that one party was not compensated for development mean that more rights existed than those that were legally enforceable. Independent parties would have reflected this dynamic in their ongoing pricing.

Realistically available options (Section A3)

The emphasis on realistically available options is a welcome one, as it allows for the reality that often at arm's length a party has little or no choice but to accept what is on offer or go elsewhere. However, we have doubts over how a taxpayer can demonstrate other realistically available options, or the fact that no other options were available. A group company may not normally conduct such an analysis as part of its commercial decision-making process in relation to a business restructuring. Could the OECD define what is expected?

Focusing too narrowly on options realistically available would require that each company in the MNE pursue only its separate commercial interests. That is the opposite of what an MNE actually does -- and indeed must do, if it is to enjoy the advantages that flow from being an MNE. The Guidelines recognise that related parties enter into arrangements that independent parties would not enter into, and adjust only for any distorting effect on profits. We presume that this part of the Discussion Draft is not meant to undermine this bedrock principle of the Guidelines.

From an economic perspective, all business decisions must take into account uncertainty in the future and incomplete information. Often, an option that is definitely more attractive than other options (a dominant alternative) cannot be identified ex ante, or the relative attractiveness of options is dependent on parameters (level of risk aversion, subjective probability of future events) that cannot be easily documented. Furthermore, in dealings between independent enterprises, information asymmetries may exist, as well as differing abilities to interpret information. This paradigm always informs any analysis of options realistically available.

Profit potential (Section B)

We fully agree that the arm's length principle does not require compensation for the loss of profit potential.

Commercial reality would be better reflected if the drafting of paragraph 65 and subsequent paragraphs were changed to make it clear that it is rights or assets that give rise to potential income or losses. The so-called profit or loss potential is not sold directly, but by being connected with underlying assets or rights.

The analysis in paragraphs 66-70 seems to be predicated on each party having access to perfect information -- not so much perfect hindsight, but perfect foresight as well. But we note the opinion that past performance may not be a useful guide to future performance. Real market transactions are almost always concluded under information asymmetries between the parties involved, who hold different expectations about the future. We are concerned that this commentary will encourage the use of hindsight to second guess what taxpayers did, with imperfect knowledge, at the time of the transaction.

Specific comment is invited on whether arm's length compensation would exist for the transfer of potential losses or liabilities. Under an insurance contract, the transferor (insured) does indeed pay the transferee (insurer). Similarly, if the question is whether independent parties consider the allocation of risks when negotiating prices, then the Guidelines already answer this in the affirmative. It seems obvious that independent parties negotiating a change in their relationship would likewise consider the new allocation of risks in agreeing to new prices. There may be examples of situations whereby arm's length parties have agreed to lump sum payments on changes to their commercial arrangements,

though this is far from a universal rule. It would be inappropriate to make it a universal requirement. It would also be impractical – what information on comparable situations would exist?

In any assessment of profit potential or loss potential, the role of forecasts will be important. We believe it would be worthwhile for the OECD to address this issue. Forecasts prepared for business purposes would greatly inform contemporaneous views over profit or loss potential.

Transfer of something of value/ongoing concern (Section C)

We believe that the fact that local intangibles may exist does not dictate that they would be compensated for at arm's length. The intangibles may not have any value. Their value may be reflected elsewhere in another transaction – for instance, in the sale of goodwill. Furthermore, local intangibles, even if they exist, might not be legally owned by the local company. Tax administrations are not entitled to require compensation when independent parties would not have provided for it.

We doubt that independent enterprises would view the example in Paragraph 94 as the transfer of an ongoing concern. In the example, M2 has to build up new operations in a new legal environment, with new facilities and infrastructure; it needs new local approvals and permits, has a partly new workforce, new transportation flows, etc. The transferor is shutting down its business, including closing its infrastructure and letting go of employees. Therefore, this could not be considered an ongoing concern with associated goodwill, and the standard models for valuation of acquisition deals could not be used: the transferred assets would have to be evaluated individually. This conclusion is confirmed by paragraphs 183-184 in Issue note 3, in which the Discussion Draft highlights the difficulty of valuing a basket of functions, assets, and risks that are lost in the restructuring, as those functions, assets, and risks may not be transferred to another party. As a consequence, the transferred assets need to be evaluated individually.

With regard to paragraphs 87 and 88 on the transfer of intangibles, we would welcome some clarification on the meaning of “good faith” and “sufficiently uncertain.” Those terms are highly subjective and can be interpreted in very different ways by tax administrations.

Indemnification for detriments (Section D)

We are uncomfortable with any analysis predicated on a presumption that a restructuring requires compensation. Viewing all future transactions (for how long into the future?) as potentially part of an indemnification opportunity for events increasingly distant in time departs too far from the arm's length principle. Furthermore, it is our experience that indemnification for potential future detriments is rarely seen in dealings between third parties, and is certainly not a universal principle. Our experience is that the position most often seen between third parties is that these matters are reflected in the prices charged in any ongoing relationship between the parties, assuming one party has the ability to influence prices to take potential detriments into account – which is only rarely the case. In any case, we believe it is extremely rare for independent enterprises to make indemnity payments for detriments when they are not contractually obligated to do so.

Issue Note 3: Remuneration of post-restructuring controlled transactions

General principle - no different application of the arm's length principle (Section B1)

We believe the statement in paragraph 130 cannot be emphasised enough: the Guidelines should not be applied differently to business restructurings from the way that they are to businesses that were structured in a particular way from the start. And we are glad that paragraph 133 acknowledges that there is no conceptual problem with a restructured enterprise being comparable to one that was set up along similar lines in the first place.

One-sided method (Section C2)

While we cautiously accept the sentiment that “choosing a one-sided method does not mean that only a one-sided analysis can be performed,” a “two-sided” analysis might lose sight of the fact that only one party is the tested party. Some comments in this section could be read as extending parts of the existing Guidelines. While we appreciate that information about “the other end of the transaction” can sometimes be of use, we are concerned that this section could be interpreted as allowing a tax administration to extend its audit of its own taxpayer to effectively involve the auditing of a taxpayer in another jurisdiction. It should be remembered that a tax administration will have better information available about its own taxpayers, and that the tested party, following the definition in paragraph 151, is the party being audited domestically.

We recommend that the Discussion Draft make it clear that a two-sided analysis that is conducted in the course of applying a one-sided transfer pricing method should be limited to matters that are relevant to determining whether the method has been correctly chosen and applied. This will largely be limited to understanding the functions, assets and risks of both parties. It should not extend to a financial review of the profitability of the non-tested party, as this would convert a one-sided method into a two-sided method.

Comparison of profits earned before and after the restructuring (Section E)

Though it is difficult to refute entirely the idea of a before-and-after comparison of profits as a sanity check, under the existing Guidelines it is sufficient to demonstrate that the pricing before and after the restructuring is arm's length.

The Discussion Draft implies that a taxpayer could be expected to justify the change in profitability on a restructuring by quantifying the arm's length return for the functions, assets, and risks transferred in the restructuring. We think this notion should be explicitly rejected. It should be sufficient for the taxpayer to demonstrate that the pricing following the restructuring is correct, and that any assets transferred on the restructuring have been priced at market value. To require a ‘reconciliation’ of profits before and after the restructuring represents a fundamental new requirement and invites disputes.

Location savings (Section F)

We suppose that the relative bargaining positions and ongoing business relationship would play a major part in deciding which party enjoys the benefit of any savings. Furthermore, “savings” arise from future transactions and this indicates that they are more likely to accrue to the enterprise entering into those transactions.

Issues Note 4: Recognition of the actual transactions undertaken

Throughout our comments, we have assumed that the terms “recharacterising” and “disregarding” are synonymous. If that is not the case, taxpayers would benefit from additional guidance on the differences between the terms.

This is a very important section for all taxpayers. Non-recognition of transactions is an area that generates considerable uncertainty for taxpayers and, unless clear and universally accepted guidance is developed, will lead to more situations where the actions of tax administrations lead to double taxation. It is clear that little consensus has been achieved during the deliberations so far, perhaps because of the difficulty of the topic.

Transactions undertaken: relationship between paragraphs 1.36-1.41 and the rest of the Guidelines (Section B)

We have concerns that paragraphs 201-202 could be misread, similar to the concerns expressed above regarding Issues Note 1. We assume that the terms “core element” in Issues Note 1 and “nature of the transaction,” in Issues Note 4 mean essentially the same thing, but we would like the OECD to elaborate on this concept to make it absolutely clear what can and cannot be done without the limitations in paragraphs 1.36-1.41 of the Guidelines do not applying. It would also be useful if paragraph 198 could be made expressly clear.

We also feel that the intent of this section would be better realised if the words “or other conditions” as used in paragraphs 198 and 201 were removed altogether. This deletion would permit tax administrations to adjust prices to reflect comparability issues, but would keep paragraphs 1.36-1.41 in point if the tax administration wanted to go further and adjust the conditions of the transaction. As the Discussion Draft is currently drafted, a tax administration might be able to adjust the conditions of a transaction and argue that because the core element or nature of the transaction is not being changed, then paragraphs 1.36 to 1.41 do not have to be considered. The line between a condition being a supplementary part of a transaction and a condition being a fundamental part of it must be expressly drawn to remove uncertainty. The Discussion Draft (specifically paragraph 201) should clarify that a tax administration is only entitled to adjust the taxpayer’s transactions within the terms of paragraphs 1.36 to 1.41.

We find the statement “the objective should be to arrive at a characterisation or structure that comports as closely as possible with the facts of the case” in paragraph 202 most welcome. The facts of the case comprise what the MNE has done - those are the facts. The Discussion Draft therefore concludes that the tax administration’s characterisation or structure must change as little as possible what the MNE has done. This is the only place in which the Discussion Draft really considers the tricky issue of what a tax administration should recharacterise to. We believe more guidance on this issue would be extremely useful, perhaps by way of examples.

Meaning of the word “exceptional” (Section C1)

Clearly, paragraphs 1.36 to 1.41 of the Guidelines exist to limit the circumstances whereby a tax administration can ignore what has happened. More guidance on when something is deemed exceptional would be extremely useful. The Discussion Draft could be interpreted to mean that ‘exceptional’ is merely a descriptive term, not meant to restrict the circumstances when a taxpayer’s actual transactions are not to be recognised. In our view, non-recognition is an extreme remedy that should be restricted to the circumstances set out in paragraphs 1.36 to .141, and the Discussion Draft should make this clear.

Determining an appropriate transfer price: meaning of ‘practically impedes’ (Section C2)

Paragraph 206 makes three important points:

- The criteria for non-recognition are cumulative under the second circumstance (that is, both criteria need to apply);
- An appropriate transfer price is an arm’s length one that takes into account comparability; and
- A tax administration must recognise a transaction when an appropriate transfer price can be found. This is true even if the transaction is not one found between independent parties, and irrespective of any doubts over the commercial rationale. This is an unambiguous clarification of the phrase “practically impedes” in the current Guidelines.

These conclusions represent much needed clarification and are a useful step forward.

Determining whether arrangements are commercially rational (Section C3)

These paragraphs recognise that MNEs operate in ways that are often not available to independent enterprises. The mere fact that a related-party arrangement is not found between independent enterprises does not make that arrangement non-arm’s-length. Because this is a crucial area, we will conduct a paragraph-by-paragraph analysis.

Paragraph 207

This paragraph states that “Some countries consider that this ‘commercially rational behaviour’ test is intended to deal with cases where a transaction has no non-tax business purpose. A large majority of OECD countries however consider that it sets a benchmark as to whether ‘independent enterprises behaving in a commercially rational manner’ would have entered into a similar arrangement.” Guidance would be useful on which interpretation is correct or, failing that, which countries subscribe to which theory.

The discussion draft implies that a large majority of countries recognise that tax is a commercial factor. How do the small minority of countries that believe tax is not a commercial factor reconcile their view with the statement in paragraph 196 that tax considerations are a commercial factor and also the demonstratively clear comment in paragraph 212?

Paragraph 208

Perhaps a way out of the problem caused by lack of agreement as to what “independent enterprises behaving in a commercially rational manner” means would be to focus on instances that are “clearly” commercially irrational, and for all OECD countries to accept that anything not “clearly” commercially irrational should not be disregarded.

Paragraph 209

The Discussion Draft states: “The OECD is of the view that at arm’s length, an independent party would not enter into a restructuring transaction that is expected to be clearly detrimental to it if it has the option realistically available to it not to do so. The phrase “clearly detrimental” is too subjective. Real business decisions are always made with incomplete information and uncertainty about the future; thus, an option that is clearly detrimental may be identifiable as such only in hindsight.

Paragraph 213

The first sentence of this paragraph states that “The OECD recognises that there can be legitimate group-level business reasons for an MNE group to restructure.” We believe that the word “legitimate” introduces an inappropriately subjective element to any analysis. However, the second sentence of this paragraph is welcome, because it allows that the commercial rationale can be viewed from a group perspective, and that from a practical point of view, an appropriate price can be used to make a restructuring arm’s length for all participating companies.

Paragraph 216

This paragraph makes it clear that there are fundamental differences between OECD members on a fundamental issue. The term “crown jewels” is arbitrary and vague. It is not appropriate as a meaningful and objective means for taxation, even more so if taxpayers are unaware which countries hold the view expressed in the paragraph. Disregarding transactions that involve the sale of a company’s “crown jewels” is likely to lead to disputes that cannot be resolved.

Economic substance

We regret that the Discussion Draft does not consider the meaning of this phrase used in paragraph 1.37 of the current Guidelines, and urge the OECD to consider a discussion based on this point.

Conclusion

We hope the OECD finds these comments useful. We greatly encourage the OECD debate in the area of business restructurings, and look forward to the next step in the process. We are of course available to expand on any of our comments and to contribute to the ongoing debate.