Mr. Jeffrey Owens
Director, Center for Tax Policy and Administration
OECD
2, Rue André Pascal
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France

Wemmel, 8 January 2010

Dear Mr. Owens,

RE: Public consultation on the Proposed revision of Chapters I-III of the OECD Transfer Pricing Guidelines

De Witte-Viselé Associates ("DWVA") wants to thank you for the opportunity given to comment on the Proposed Revision of Chapter I-III of the OECD Transfer Pricing Guidelines ("Proposed OECD guidelines") issued on 9 September 2009.

As transfer pricing practices and experience of both tax practitioners and tax administrations have evolved over time, the business community and the global economic market conditions are changing over time, we acknowledge the difficult trade-off that represents drafting guidelines that one the one hand are sufficiently narrow to avoid misinterpretations and create a certain legal stability and on the other hand are sufficiently adaptable to fit all the taxpayers economic particularities and tax administrations specific legal (documentation) requirements.

By means of this letter we would like to congratulate the OECD for the outcome of those proposed OECD guidelines which incorporate an important number of concepts and guidance that are of daily use for tax practitioners in the transfer pricing field and should limit the number of discussions with tax administrations in the field of comparability analyses. Despite the never-ending need for clarification, we feel that those proposed OECD guidelines constitute an important step supporting major transfer pricing concepts and practices that have been used over the last fifteen years.

Taking advantage of the opportunity that was given to us, DWVA commented below the sections of the proposed OECD guidelines where we felt the reasoning of the OECD was in our view not sufficiently apparent and may still create uneven situations between taxpayers and tax administrations. We also noted some areas where additional guidance would add to a more secure framework for the transfer pricing practice.

We respectfully hope that those comments will help to clarify some issues that the proposed OECD guidelines may contain, and look forward to see definitive guidelines published.

In the meantime, we remain at your disposal for any further explanation regarding the comments we made.

Sincerely,

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Chapter I

The Arm's Length Principle

The first chapter of the proposed OECD guidelines is, in its major part, in line with the first chapter of the transfer pricing guidelines published in July 1995.

DWVA did not notice any significant points of discussion regarding the amendments made to this first chapter.

Chapter II

Transfer Pricing methods

Part I: *Introduction*

The second chapter of the proposed OECD guidelines introduces a number of significant changes comparing to the former transfer pricing guidelines. In particular, DWVA noticed in the first part a modification in the hierarchy of the methods, removing the status of "last resort method" of the Transactional Net Margin Method ("TNMM"). Indeed, although a secondary preference between the methods still exists, we noticed that the different methods tend to be considered at the same level. DWVA however feels that the proposed OECD guidelines could benefit from additional clarifications regarding the selection of "the most appropriate method".

As it will discussed in more details below, DWVA also observed that the current absence of hierarchy between the methods in combination with the explanation of the comparability analysis process , at some occasions throughout the proposed OECD guidelines, create some ambiguity or perception that in many cases more than one method should be used for the determination of an arm's length remuneration.

A. Selection of the most appropriate transfer pricing method to the circumstances of the case

1. Justification expected from the taxpayers regarding the selection of the most appropriate transfer pricing method

Paragraph 2.1 of the proposed OECD guidelines bases the selection of the most appropriate transfer pricing method on the circumstances of the controlled transaction, the functional analysis of the tested party and the availability of reasonably reliable information. Given that the "*selection of a transfer pricing methods always aims at finding the most appropriate method for a particular case"* (§2.1), we understand that it is expected from the taxpayer to consider "*the respective strengths and weaknesses*

of each of the OECD recognized methods" (§2.1) during the selection process. This provision in combination with the elimination of the hierarchy amongst the methods, in our view, imposes an additional documentation burden, since in many cases, various transfer pricing methods can be considered appropriate. The question as such arises how to evaluate whether one method is more appropriate than the other without performing part of the comparability analysis under each method in order to identify potential practical issues such as lack of data, impact of differences in accounting standards, etc. Especially with respect to the (non)-use of the transactional profit split method, this might create a substantial additional burden to taxpayers, being a direct consequence of having all transfer pricing methods at the same hierarchical level.

Having said this, we noticed that paragraph 2.7 of the proposed OECD guidelines seem to modify this first requirement regarding the analysis of each method by saying that "*the guidance of paragraph 2.1 (…) does not mean that all the transfer pricing methods should be analyzed in depth or tested in each case in arriving at the selection of the most appropriate method"* (§2.7).

Some clarifications on which justification(s) is expected from the taxpayers with respect to the selection of the most appropriate transfer pricing method may help to remove this ambiguity. It seems reasonable to simply expect from the taxpayer to demonstrate that the selected transfer pricing method can be applied in a reasonably reliable way (e.g. according to the comparability analysis process set out in chapter III). However, it seems impossible to achieve it without going through a detailed analysis of all the other methods.

2. Semi-hierarchy remaining among the methods "equally reliable"

Paragraph 2.2 establishes a double preference between the transfer pricing methods:

- The Comparable Uncontrolled Price Methods ("CUP") over all the other methods ; and
- The traditional methods over the transactional methods.

Those preferences are only applicable when the methods concerned "*can be applied in an equally reliable manner*". Some clarifications would be welcomed on the actual sense of "equally reliable manner" as it could be expected that two methods can only be equally reliable insofar they produce similar arm's length results.

Nevertheless, the selection of the most appropriate method and semi-hierarchy of the method set at paragraph 2.2 should provide to the taxpayer the possibility to choose in most cases one single, (being the most appropriate) transfer pricing method. We recommend, despite the provisions of 2.10, to reconsider the wording throughout the text of the proposed OECD Guidelines, where one often speaks about "method or methods", as this may give the perception to tax administrations that often more than one transfer pricing method should be used which on its turn may lead to an increased uncertainty for taxpayers. DWVA is of the opinion that in case more than one transfer pricing method is used, one

should consider a primary and secondary method, whereby the latter is meant to corroborate the primary analysis. This not only in cases of unusual outcomes as indicated in 2.11 but also in cases where for example : the number of comparable transactions is limited under the application of the most appropriate method or in order to finetune the positioning within the arm's length interquartile range resulting from the use of the primary comparability analysis.

With respect to the use of a secondary method, we would like to suggest whether the OECD should not consider to let go the strict application of the independency criterium under very exceptional circumstances. Indeed, when performing transfer pricing analyses for certain industries that are heavily vertically integrated, it is often impossible to find independent third parties performing comparable transactions. In such exceptional cases, it might be considered to corroborate the results of a primary comparability analysis based on independent but less comparable transactions with the results of an additive search for dependent but more comparable transactions.

Chapter II

Transfer Pricing methods

Part II: ***Traditional transaction methods***

No significant modifications have been made to the former chapter II of the transfer pricing guidelines. DWVA has no comments in this respect.

Chapter II

Transfer Pricing methods

Part III: ***Transactional profit methods***

A. Transactional profit split method

DWVA does not have particular comments on the section regarding the profit split method and its guidance.

The only remark we would like to raise is that as a result of the elimination of the hierarchy of transfer pricing methods, the pro and cons of the transactional profit split method will need to be more frequently considered than under the existing principles for selecting the most appropriate transfer pricing method. This may lead to a substantial additional burden in terms of information gathering and analysis in comparison what is done by transfer pricing practitioners today. Furthermore, since tax administrations are more and more trying to perform a two-sided review during transfer pricing audits, even in cases where a one-sided transfer pricing method and approach is most appropriate based on the functional analysis, the absence of any hierarchy may enforce this practice (despite the provisions of 3.22 in this respect) as taxpayers will have to defend and document in more detail that a two-sided method (transactional profit split method) is not more appropriate than the one-sided OECD transfer pricing methods.

B. Transactional net margin method

The TNMM is the most used transfer pricing method and the guidance provided by the proposed OECD guidelines in this respect confirms and clarifies what tax administrations and tax practitioners were conducting for the last fifteen years. Some topics may however deserve further clarifications.

1. Notion of disbursement

The notion of disbursement of "pass-through costs" defined in paragraph 2.134 of the proposed OECD guidelines may need specific clarifications. According to the proposed OECD guidelines, the distinction to be made between costs subject to the application of a mark-up and pass-through costs (disbursements) lies in particular on the determination of the value added by the tested party in relation to those costs.

Although this definition may apply in many cases, there are also other cases where the tested party does not add any value in relation to those costs but they nevertheless might enter into the cost base for the application of the mark-up. In particular if we consider the case of a service, any cost that is absolutely necessary for the provision of the intercompany service (or without which no service could be rendered) should be considered in the cost base for the application of a mark-up, regardless whether it concerns an internal or outsourced cost.

To take an example, let's consider a tested party providing warehousing services in the healthcare industry to its related party (including sorting and logistic services). This tested party hires a third party company responsible for the cleaning of the warehouse. In such a case, all cleaning costs (even if subcontracted to a third party, without any value added by the tested party) should be considered for the application of an arm's length mark-up as part of the full cost basis for rendering "warehousing services". What matters in this case is actually the necessity of the cost for the provision of the services rather than the value added to the cost incurred.

2. Use of actual costs

The paragraph 2.136 of the proposed OECD guidelines states that

> "*Using actual costs may raise an issue because the tested party may have no incentive to carefully monitor the costs. In arrangements between independent parties, it is not rare that a cost savings objective is factored into the remuneration method.*"

Proposed OECD Guidelines, § 2.136

DWVA does not fully agree with this statement, although the use of actual costs does indeed guarantee a stable remuneration of the tested party which may lead to remuneration of inefficiencies, the use of relevant performance indicators (KPI's) may still monitor this issue. Furthermore, solely working on budgeted or standard costs for a low risk routine service provider or manufacturer may create substantial issues as actual costs can deviate from budget or standard due to external factors outside the control of the party concerned (e.g. major change in market prices, market demand, etc.). In practice, often year-end adjustment models are put in place with certain caps and floor mechanisms whereby a distinction is made between costs that can be controlled by the tested party and the costs that are outside the control of the tested party. As such the transfer pricing policy on the one hand can

reflect the actual effects of cost savings/inefficiencies obtained in relation with cost items that are controllable for the tested party and on the other hand limits the risks related to the potential evolution of non-controllable costs in the hands of the low risk tested party.

3. Use of berry ratio

Beside the use of the berry ratio for intermediary sales activities as set out in 2.142, we would like to point out that in our view, the use of a berry ratio can also be useful for determining arm's length profits for sales agency activities. Indeed, in practice, it is often hard to find sound independent comparables for sales agency activities and one has to search for independent low risk buy-sell distributors. The berry ratio might than be a good instrument to determine the value added linked to the pure sales activity effort insofar a good distinction between cost of goods sold and operating costs can be made for the third party low risk buy-sell distributors and the prefinancing of the goods and inventory risk in the hands of the latters is negligible.

Chapter III

Comparability Analysis

The third chapter dealing with the comparability analysis is intended to be one of the central chapters of the OECD transfer pricing guidelines. DWVA identified in this chapter a number of issues subject to controversy that may deserve some further clarification.

A. Expectations regarding the search for reliable sources of comparables

DWVA noticed a contradiction existing between paragraph 3.2 and 3.3.
Indeed, although §3.2 states that:

"*This [ndlr: finding the most reliable comparables] does not mean that there is a requirement for an exhaustive search of all possible sources of comparable as it is acknowledged that there are limitations in availability of information and that searches for comparable data are burdensome*"

§3.3 seems to step back from that position when saying:

"*The fact that reasonable efforts have been made in finding and selecting comparables cannot rule out the possibility that more reliable comparable data may ultimately be found and used in determining an arm's length outcome*".

This last sentence of paragraph 3.3 adds uncertainty as to the efforts that the taxpayer is expected to undertake to demonstrate a "reasonable effort" in finding comparable data. After demonstrating that a reasonable effort has been made to find reliable data, taxpayers should be relieved from the responsibility of finding more reliable data, meaning be protected against transfer pricing penalties. The proposed OECD Guidelines suggest in the same Chapter III a typical search process that, if followed rigorously, could in our view demonstrate the reasonable effort undertaken. Saying that no safe harbor is given, seems acceptable, but puts the taxpayer in an unsecure position concerning penalty protection. Therefore, we recommend to consider the application by taxpayers of the typical search process as described in Chapter III in a professional way as a save harbor against transfer pricing penalties but not against transfer pricing adjustments..

B. Typical process

The typical sequential order presented at paragraph 3.5 represents a great progress and clarification of what is expected from the taxpayer and tax administration in terms of comparability analysis. Although the steps follow a chronological order in the analysis, some of them seem redundant and may create an excessive burden for the taxpayer conducting the comparability analysis.

Step 3 of the typical search process aims at choosing the tested party, as well as the most appropriate transfer pricing method to the circumstances of the case. We understand that under this step, the

taxpayer is expected to select the most appropriate method regardless the data availability constraints (identified later in Step 5). This would therefore represent a theoretical exercise, guiding the search for source of information.

Step 4 is then aiming at identifying and reviewing internal comparables, which according to §2.2, should be preferred over any other method when applied in an equally reliable manner. Due to the preference given to internal comparables over any other method (unless not equally reliable), we estimate that this step should be integrated to the selection of the method in Step 3 as the identification and review of internal comparable will influence the transfer pricing method to be applied.

The proposed OECD guidelines suggest at paragraph 3.6 to carry out a reiterative exercise between Step 5 and 7 in order to select the most appropriate method. We estimate that it may not be necessary to go through step 7 in order to select the most appropriate method. Step 7 should as much as possible be reserved to the most appropriate method selected in order to limit the documentation burden for taxpayers.

Using the guidance provided in Chapter I of the proposed OECD guidelines regarding the comparability factors (§1.38 - §1.62) and the recommendations of §2.1 and 2.2, taxpayers and tax administrations should in most cases be able to agree on one single most appropriate method to apply based on the information available, without going through the comparable selection process (step 7) for various methods.

C. Comparable uncontrolled transactions

The proposed OECD guidelines introduced in paragraph 3.36 the concept of “minority shareholder” in the transfer pricing guidelines, stating that their presence may be one factor leading to arm’s length transactions. We estimate that the position of the OECD is not clear in this respect. We encourage the OECD to provide a clearer definition of the “minority shareholders” as well as their treatment from a transfer pricing perspective. We indeed consider that the treatment of minority shareholder could have a significant impact on the independency issues that tax practitioners are facing while conducting comparability analyses and comparable searches.

D. Comparable uncontrolled transactions (“secret comparables”)

DWVA is generally against the use of information that was undisclosed to the taxpayers at the moment of setting/testing their transfer prices. As mentioned in the proposed OECD guidelines (§3.35), we estimate unfair to calculate the adjustment of a taxpayer’s transfer price on the basis of information on which the taxpayer had no access at the time of either setting its transfer prices (under a “arm’s length price-setting” approach described at § 3.68) or at the moment of testing its transfer prices (under an “arm’s length price outcome-testing” approach described at § 3.69) and conducting appropriate year-end compensating adjustments.

The use of information undisclosed to taxpayers generally leads to hindsight as it is generally revealed after the taxpayer still has a control over the determination of its transfer prices. For that reason we estimate that such information should not be allowed in the context of transfer pricing analyses.

E. Comparability adjustments

By reading the three paragraphs 3.46 to 3.53, DWVA is of the understanding that the OECD is on the one hand stipulating that comparability adjustments having a material effect on the comparable transaction may indicate that the third party transaction may in fact not be sufficiently comparable and on the other hand is saying that comparable adjustments should not be performed "*to correct differences that have no material effect on the comparison*" (§ 3.51).

We estimate that the decision of making or not comparability adjustments should not be based on the modification of the results they will generate. Such position may lead to very arbitrary decisions regarding the materiality of an adjustment justifying the rejection of a comparable. It could also lead to endless discussions about adjustments with tax administrations.

As soon as the comparability adjustments are not intended to modify major comparability criteria but are only intended to adjust clearly identifiable differences in the financial situation of the comparables vis-à-vis the tested party, there should be no reason to reject them based on their effect over the results. Following a similar reasoning as for the loss making comparables (cf § 3.64), comparables for which comparability adjustments lead to very material changes to their results should simply "trigger further investigation in order to establish whether or not it can be comparable".

Additional guidance from the OECD on what is considered an acceptable adjustment may help both taxpayers and tax administrations to assess when adjustments are acceptable or not.

Remark:

Comparability adjustments should also be considered in the perspective of the comparability analysis as a whole. In particular, existing arguments challenge the simultaneous use of diagnostic ratios (quantitative criteria dealt at § 3.42 of the proposed OECD guidelines) together with comparability adjustments, the point being that when comparables have been filtered based on their financial structure, they should not be subject to additional comparability adjustments in the same area. The combination of both tools at the time may therefore create some discussions. Some guidance from the OECD on this matter would be helpful to determine if a choice should be operated between diagnostic ratios and comparability adjustments.

F. Compliance issues

One of the main points of discussion concerns the compliance of the transfer pricing documentation with the principles set forth in the OECD guidelines. As a result, section C of chapter III of the proposed OECD guidelines may attract a lot of attention from both taxpayers and tax administrations that wish to determine whether a transfer pricing documentation is compliant.

When reading paragraphs 3.79 to 3.82 it is still hard to determine what would be the minimum compliance requirements to assert that documentation is compliant with the proposed OECD guidelines.

In particular § 3.80 dealing about compliance issues states that "*there is no requirement for an exhaustive search of all possible relevant sources of information*", which seems in contradiction with the essence of § 3.3 stating that "*the fact that reasonable efforts have been made in finding and selecting comparables cannot rule out the possibility that more reliable comparable data may ultimately be found and used in determining an arm's length outcome*". Indeed, on the one hand, the proposed OECD guidelines seems to mention that compliance do not imply searching for all reliable source of information whereas, on the other hand, the proposed OECD guidelines state that taxpayers may see their transfer prices adjusted based on more reliable data that may ultimately be found (disregarding the reasonable effort undertaken).

Although we acknowledge that a compliant documentation cannot either guarantee that transfer prices fixed on that basis will not be adjusted (only an Advanced Pricing Arrangement can) nor that the transfer prices are at arm's length, some minimum compliance criteria should decrease the risk of compliance related penalties.

Furthermore, paragraph 3.81, a part of weighting the documentation efforts according to the relative importance of the transaction involved, entails that a transfer pricing documentation (or at least the financial information on comparables and its relative comparability) should be updated annually, which is above the legal requirements in some countries and in general not in line with the evolution and impact of macro-economic principles on a micro-economic business model (except in times of important economic downturn as we have known recently). DWVA is of the opinion that the paragraph, as it is written now, may create the general expectation from the tax administrations that documentation should be updated annually in order to be compliant with the proposed OECD guidelines, creating an important documentation burden for the taxpayers. Even in the case of new transactions or complex transactions the conditions under which they are operated may not change every year. As soon as the taxpayer is able to prove that the conditions remained the same, in our view, there should be no obligation to conduct an annual update of the comparability analysis and full transfer pricing documentation. Similarly, the financial information of the comparables may need to be updated only if some significant economic change occurred, justifying an adjustment of the transfer prices levels. Based on our practical experience, a three year time horizon for updating transfer pricing comparability analyses seems reasonable under stable economic circumstances.