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January 8, 2010

By E-Mail

Mr. Jeffrey Owens
Director
OECD Centre for
Tax Policy & Administration

Re: Proposed Revisions of Chapters I-III of the Transfer Pricing Guidelines

Dear Mr. Owens,

Thank you for the opportunity to provide comments to the Proposed Revisions of Chapters I-III of the Transfer Pricing Guidelines ("Proposed Revisions").

Introduction

As a general comment, we are in agreement with the direction of the changes in the Proposed Revisions, in particular, the move to legitimize the Transactional Net Margin Method ("TNMM") by elevating its status to more than a method of last resort. We see this as recognition of the real and practical limitations in applying transfer pricing methodologies and as a result, we see the concept of the "most appropriate method" as a practical and workable solution to these limitations.

In addition, we welcome the detailed guidance on performing comparability analyses as provided in the proposed Chapter III. In particular, given the imperfect nature of the comparables that will often be found, it is important to ground this process to the principles of transparency, systematicness and repeatability.

We are pleased to see that the Proposed Revisions have incorporated many of the comments expressed by the business community in the responses to the Discussions Drafts[1], as well as the comments expressed in the Comparability and Profit Methods Consultation[2]. However, we believe there are still a number of important principles that the Proposed Revisions do not address or are not sufficiently clear on and as such, we take this opportunity to re-iterate our position on what we believe are the more important or problematic issues that have not been appropriately addressed, in our view.

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[1] "Discussions Drafts" refer to: i) Comparability: public invitation to comment on a series of draft issues notes (May 2006); and ii) Transactional Profit Methods: discussion draft for public comment (January 2008).
[2] "Comparability and Profit Methods Consultation" refers to the consultation with business commentators on the topics of comparability and profit methods under the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations held in November 2008.

I. Recommended Modifications to Proposed Revisions

Selection of the "Most Appropriate Method"

1. Paragraphs 2.1 to 2.9 describe how the principle of the most appropriate method should be applied. Paragraph 2.1 lists the factors to consider in determining the most appropriate transfer pricing methodology and it would appear that paragraphs 2.2 to 2.5 and the latter part of paragraph 2.9 provide additional guidance in interpreting the factors listed in paragraph 2.1.

2. However, this link is not very clear and the patchwork of old and new paragraphs seems somewhat disjointed because the old wording was developed within the context of a hierarchy of methods while the Proposed Revisions are advocating the "most appropriate method" approach. Attempting to preserve the paragraphs without rewording to reflect the new concept of the "most appropriate method" therefore results in inconsistencies. We recommend that the old wording be completely eliminated and the structure of this section be modified in the following manner:

   i. Define the concept of "most appropriate method" in determining the transfer pricing methodology to use.

   ii. List the factors to consider and further describe each factor and / or provide examples of how these factors should be applied and interpreted.

   iii. Describe how taxpayers and tax administrations should document their selection of the most appropriate method (e.g. that the applicability of any particular method need not be disproved (para 2.1); that all transfer pricing methods need not be analysed in depth or tested and may be incorporated into the typical search process (para 2.7)).

3. With regard to the latter point there is an inconsistent message that on the one hand, the taxpayer should not have an unrealistic burden of proof in the choice of the most appropriate method and on the other hand the taxpayer is discouraged from choosing a method "simply because there are difficulties in obtaining data" (para 2.4) or "simply because some rigid standard of comparability is not fully met" (para 2.9).

4. Paragraph 2.4 seems to suggest that the taxpayer has alternative ways of obtaining data and that it is only a question of how far one should pursue such data. In reality, the most significant constraint in using any particular comparable or methodology lies in the availability of data to the taxpayer. In most cases (only with the exception of an internal comparable uncontrolled transaction ("CUT")) reliable third party information is generally only available from public company filings. There are few, if any, other legitimate ways of obtaining third party data that can be disclosed in a transfer pricing study. Therefore, if the reason for selecting a certain transfer pricing method is driven by the lack of available data, we do not see this as a less legitimate reason than any other.

5. Paragraph 2.9 refers to the premature exclusion of data that could occur because some taxpayers may apply a “rigid standard of comparability”. This type of statement raises the question as to what standard of comparability must be met and what type of evidence is necessary to demonstrate that such standard of comparability is not too rigid. For instance, is a qualitative analysis and explanation sufficient to discount the use of a CUT because there are factors that the taxpayer believes affect the price of the comparable, but that cannot be quantified because data is not available to make a quantification of the impact of that variable on the price. In other words, is the taxpayer required to do some kind of econometric analysis to demonstrate the impact of a particular factor on the terms and conditions of the potential comparable to demonstrate that it is not comparable to the tested transaction? This seems to be an unreasonable burden to place on taxpayers and seems to contradict the OECD’s earlier statements that all transfer pricing methods do not have to be analysed in depth before the most appropriate method is selected. To avoid further ambiguities, we recommend this type of wording be eliminated.

Preferred Methods

6. Paragraph 2.2 is based on old paragraph 2.49 and reads as follows:

   “Traditional transaction methods are regarded as the most direct means of establishing whether conditions in the commercial and the financial relations between associated enterprises are arm’s length. As a result, where, taking account of the criteria described at paragraph 2.1, a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transaction method is preferable to the transactional profit method. Moreover, where taking account of the criteria described at paragraph 2.1, 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…”

7. In our view, this paragraph is unnecessary because if the criteria described in paragraph 2.1 are adequately considered in determining the “most appropriate method”, then we believe that all else being equal, the conclusion ought to be that the CUP method is the “most appropriate method” because it is a more robust method of measuring an arm’s length price. One of the criteria stated in paragraph 2.1 includes the “respective strengths and weaknesses of each of the OECD recognised methods” and the existing paragraphs 2.6 to 2.49 (which are to be included as paragraphs 2.12 to 2.59 of the Proposed Revisions) describe in detail the strengths, weaknesses and appropriate use of the various methodologies.

8. In the same vein, we question the inclusion of paragraph 2.8 and propose that the concept of using non-OECD recognised methods be included in the discussion of the “most appropriate method”. In other words, that the most appropriate method may be a method that is not one of the OECD “recognised methods” but may be appropriate in the circumstances having regard to all of the factors to consider in making such a determination.

9. Maintaining these paragraphs appears to preserve the hierarchy of methods and is contrary to the most significant change in direction of the Proposed Revisions, which is to recognize that the “most appropriate method” should be selected, taking into account the various factors indicated in paragraph 2.1 and recognizing that the selection of the most appropriate method is dependent on various factors and not only on the strength of a particular methodology.

Secondary Method

10. Paragraph 2.10 and 2.11 of the Proposed Revisions discusses the use of a secondary method in certain circumstances. We agree with the first two sentences of paragraph 2.10:

    "The arm's length principle does not require the application of more than one method for a given transaction (or set of transactions that are appropriately aggregated following the standard described at paragraph 3.9), and in fact undue reliance on such an approach could create a significant burden for taxpayers. Thus, these Guidelines do not require either the tax examiner or taxpayer to perform analyses under more than one method.

11. However, the next sentence should be modified as follows, to better reflect the application of the most appropriate method:

    "While in some cases the selection of a method may not be straightforward and more than one method may be initially considered, ~~generally it will be possible to select one method that is apt to provide the best estimation of an arm's length price~~ ***the selection of the transfer pricing method considering the factors listed in paragraph [to insert based on above recommendations] above will result in the most appropriate method for particular facts and circumstances."***

12. Paragraph 2.10 states, in part:

    "However, for difficult cases, where no one approach is conclusive, a flexible approach would allow the evidence of various methods to be used in conjunction. In such cases, an attempt should be made to reach a conclusion consistent with the arm's length principle that is satisfactory from a practical viewpoint to all the parties involved, taking into account the facts and circumstances of the case, the mix of evidence available, and the relative reliability of the various methods under consideration."

13. It would seem that the above recommended action is already integrated in the process recommended to select the most appropriate method. Therefore, this comment is not only redundant, but suggests that a different transfer pricing methodology should be obtained after applying the same process that was already applied in selecting the "most appropriate method".

14. Finally, the last part of paragraph 2.10 refers to paragraphs 3.57 to 3.58 for a range of arm's length figures.

    "See paragraphs 3.57-3.58 for a discussion of cases where a range of figures results from the use of more than one method."

15. Paragraph 3.57 is adopted from existing paragraph 1.46 and therefore does not reflect the proposed changes, in particular the “most appropriate method” approach to selecting a transfer pricing methodology.

    “A range of figures may also result when more than one method is applied to evaluate a controlled transaction. For example, two methods that attain similar degrees of comparability may be used to evaluate the arm’s length character of a controlled transaction.”

16. Referring to our comments above in paragraph 7 we do not believe that two methods should be equally reliable if the process of selecting the most appropriate method is properly applied.

17. Therefore, we propose the elimination of the wording referred to in paragraphs 12 and 14 above.

18. Paragraph 2.11 then goes on to state:

    “Where a secondary method is used to corroborate a primary method, its purpose is to identify unusual outcomes that might suggest the need to further review the selection and application of the primary method to confirm whether or not it is the most appropriate to the circumstances of the case.”

19. We believe that a secondary method should not be used to validate and substantiate the result of a primary method for two reasons. In the first instance, it is likely that different ranges will arise from two different methods. This is recognized in paragraph 3.57 which states:

    “Each method may produce an outcome or a range of outcomes that differs from the other because of differences in the nature of the methods and the data, relevant to the application of a particular method, used.”

20. The mere fact that a different result was achieved by applying a secondary method does not in itself imply that the primary method produced an “unusual outcome”. Again, this is also confirmed in paragraph 3.57:

    “No general rule may be stated with respect to the use of ranges derived from the application of multiple methods because the conclusions to be drawn from their use will depend on the relative reliability of the methods employed to determine the ranges and the quality of the information used in applying the different methods.”

21. Secondly, if the primary method is selected pursuant to the process suggested in determining the “most appropriate method” then why would the result of a secondary method suggest that the result of the primary method is flawed? This logic appears to suggest that results of the secondary method may be more reliable than the first method and if that is the case, then the secondary method should have been chosen as the “most appropriate method”.

22. The selection of the most appropriate method is an important and integral part of the comparability analysis. The most appropriate method is selected only after an extensive examination of the controlled transaction and the particular circumstances of the case. Transfer pricing methods have different comparability thresholds and, as such, will more often than not produce different arm's length results. Once a method is selected by the taxpayer as the most appropriate method, based on relevant comparability factors, the strengths of each of the methods, the availability of reliable data and the different outcomes produced by different methods should not supersede the method selection process.

23. Hence, we suggest that paragraph 2.11 of the Proposed Revisions be eliminated and the necessity of a secondary method, in any case, not be recommended.

24. Consequential adjustments to this recommendation include the elimination of paragraph 3.57 in its entirety and in paragraph 3.58, the following changes:

> *"Where ~~the application of one or more methods produces a range of figures,~~ a substantial deviation among points in ~~that~~* ***a*** *range* ***exist,*** *~~may indicate that the data used in establishing some of the points may not be as reliable as the data used to establish the other points in the range or that~~ the deviation may result from features of the comparable data that require adjustments. In such cases, further analysis of those points may be necessary to evaluate their suitability for inclusion in any arm's length range."*

Reasonably Reliable Comparables

25. We are in agreement with paragraph 3.2, which recognizes that it is not reasonable to expect an "exhaustive search" to be done for the perfect comparable (again, the notion that there is no perfect comparable seemed to be agreed to by most parties during the Comparability and Profit Methods Consultation) and that therefore, "reasonably reliable comparables" are the "the most reliable comparables in the circumstances of the case, keeping in mind the above limitations".

26. These limitations consist in the availability of information on finding potential comparables. However, in paragraph 3.3, the OECD states that,

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

27. This clearly contradicts the context of paragraph 3.2. If the taxpayer has made reasonable efforts and performed a comparability analysis that meets the criteria as set out by the OECD, the comparables that are selected, based on the information available to the taxpayer at the time of the analysis, should be considered as the most appropriate comparables. As such, we recommend that Paragraph 3.3 be eliminated.

Comparability Analysis Typical Process

28. Paragraphs 3.5 and 3.6 describe a typical process that should be undertaken in conducting a comparability analysis. Overall, we are pleased to see this practical and clear framework and, in particular, we believe that this process will help to ensure that the comparability analysis is "transparent, systematic and repeatable", key principles to espouse.

29. One suggestion is to include in Step 6, Selection of the most appropriate transfer pricing method, sub-steps that list the process for selecting the most appropriate method which should correspond to paragraph 2.1.

    For example:

    Step 6: Selection of the most appropriate transfer pricing method;

    Step 6a: Consider the various transfer pricing methodologies available and their respective strengths and weaknesses;

    Step 6b: Appropriateness of method considering the nature of the controlled transaction;

    Step 6c: Consider availability of reasonably reliable information;

    Step 6d: Consider the degree of comparability of controlled and uncontrolled transactions;

    Step 6e: Consider the reliability of comparability adjustments.

Information Undisclosed to the Taxpayer

30. Paragraph 3.35 states the following:

    > *"Tax administrators may have information available to them from examinations of other taxpayers or from other sources of information that may not be disclosed to the taxpayer. However, it would be unfair to apply a transfer pricing method on the basis of such data unless the tax administration was able, within the limits of its domestic confidentiality requirements, to disclose such data to the taxpayer so that there would be an adequate opportunity for the taxpayer to defend its own position and to safeguard effective judicial control by the courts."*

31. While the OECD recognizes the inherent inequity in using data that is unavailable to taxpayers (a.k.a. "secret comparables"), it is not sufficiently categorical in its rejection of such practices. The above paragraph seems to suggest that this practice is acceptable as long as the information is subsequently disclosed to the taxpayer. This clearly misplaces the issue at hand, which is the unfair use of data that is **not available** to the taxpayer at the time it is setting its transfer price. This not only contradicts the OECD's earlier recognition that an exhaustive search is not expected, nor practical, but even if it was, this is data that is not accessible to the taxpayer.

32. Moreover, this is clearly against a cornerstone principle set forth in the comparability analysis, which is that the search process should be “transparent, systematic and repeatable”. Data on comparables obtained by virtue of a tax administration’s privileged status and access to data, is not data that is obtained transparently, systematically and is certainly not repeatable by the taxpayer.

33. We recommend the modification of paragraph 3.35 to state clearly that use of information not available to the taxpayer should never be used by a tax administration in evaluating the arm’s length nature of the transfer prices used.

Arm’s Length Range

34. In the Proposed Revisions the OECD made certain changes to the description of the application of the arm’s length range[3] in performing a comparability analysis. We agree with the principle in paragraph 3.56 that recognizes the use of statistical tools that take account of central tendency (e.g. the interquartile range)[4].

35. However, in our view, as stated in the Comparability and Profit Methods Consultation the use of an interquartile range should be driven by the results of the search for comparables. For example, if the range of results is narrow, then the interquartile range has little or no value since a narrow range is indicative of the robustness of the results. On the other hand, if the range of results is wide, provided that the taxpayer applied the most appropriate method and followed the 10-step process in performing a comparability analysis, the interquartile range can be a useful tool to obtain the central tendency of the results.

36. We believe that the current wording of paragraph 3.56 of the Proposed Revisions does not provide sufficient guidance on the application of statistical tools. As such, we would ask the OECD to provide additional guidance, including examples, on the proper use of statistical tools.

37. Paragraph 3.59 of the Proposed Revisions, which is paragraph 1.48 of the current OECD Guidelines, indicates that if the results of the controlled transaction fall outside the arm’s length range asserted by the tax administration, the taxpayer should have the opportunity to present arguments that the arm’s length range includes their results. It is not clear whether the OECD refers to the arm’s length range as determined by the taxpayer or the one established by the tax administration. Moreover, the current wording is contradictory as it suggests that even if the results are outside the range, it can be shown that they are within an arm’s length range.

38. We therefore recommend the following changes to paragraph 3.59:

    “If the relevant conditions of the controlled transactions (e.g. price or margin) are within the arm’s length range ***as established by the taxpayer****, no adjustment should be made. If the relevant conditions of the controlled transaction (e.g. price or margin) fall outside the arm’s length range* ***as*** *asserted by the*

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[3] See paragraphs 3.54 to 3.65 of the Proposed Revisions
[4] See paragraph 3.56 of the Proposed Revisions

tax administration, the taxpayer should have the opportunity to present arguments that the conditions of the transaction satisfy the arm's length principle, and that ***its*** *arm's length range* ***consists of reasonably reliable comparables*** ~~*includes their results*~~*. If the taxpayer is unable to establish this fact, the tax administration must determine how to adjust the conditions of the controlled transaction taking into account the arm's length range."*

39. We believe that these changes reflect a principled approach to assessing taxpayers, which begins with a tax administration's assessment of the comparability analysis that was performed by the taxpayer and not simply an assessment of the results of the range. Provided that the taxpayer applied the most appropriate method and followed the 10-step process in performing a comparability analysis, the tax administration should only introduce its own "arm's length" range if it itself, has also followed the process of selecting the most appropriate method and the 10-step process in comparability analysis.

40. Paragraphs 3.60 and 3.61 of the Proposed Revisions address the issue of ranking points within the arm's length range. This issue was discussed in our earlier submission dated November 30, 2006 as well as during the Comparability and Profit Methods Consultation. We reiterate our position that there should not be any ranking of points in the range because there is no need to have a range to begin with if the most comparable transaction can be identified.

41. Even if the comparable transactions in the range represent different degrees of comparability, in practice it is impossible to rank these subjective criteria in order to evaluate which comparable is in fact a "most reliable comparable". Moreover, the idea of ranking and identifying the most reliable comparable is contrary to the concept of "reasonably reliable comparables" that was introduced in new paragraph 3.2 of the Proposed Revisions. Therefore, we propose to eliminate paragraphs 3.60 and 3.61 from the Proposed Revisions.

42. Another issue discussed by the OECD within the context of the arm's length range is extreme results. We agree with the OECD's proposed wording in paragraphs 3.62 to 3.65. In particular, we strongly agree that the extreme results should be analyzed more carefully to identify any abnormalities and that there should not be any general overriding rule on the inclusion or exclusion of loss-making comparables.

Timing of Collection of Information

43. Paragraph 3.68 addresses the timing of information available at the time the transfer price is established:

"In some cases, taxpayers establish transfer pricing documentation to demonstrate that they have made reasonable efforts to comply with the arm's length principle at the time their intra-group transactions were undertaken (hereinafter "the arm's length price-setting" approach), based on information that was reasonably available to them at that point. Such information includes not only information on comparable transactions from previous years, but also expectations about market trends. In effect, independent parties at arm's length would not

base their pricing decision on past information alone, but would take account of market expectations."

44. Our understanding of the last sentence of this paragraph, "In effect, independent parties at arm's length would not base their pricing decision on past information alone, but would take account of market expectations" is that taxpayers are expected to somehow make adjustments of the comparables data to take into account future market expectations. We would like to ask the OECD for clarification on what type of future market expectations or trends would be considered and additional guidance on how any adjustments for future market expectations would be incorporated in the transfer price.

45. Moreover, we question whether such practice is at all useful if the transfer price is adjusted at year end based on observations of arm's length pricing (described as the arm's length outcome-testing approach in paragraph 3.69).

II. Other Recommendations

Safe Harbours and Industry Data

46. We realize that comments obtained pursuant to the Discussions Drafts and Comparability and Profit Methods Consultation were carefully considered by the OECD in preparing the Proposed Revisions. However, we would like to re-iterate our strong position advocating the use of safe harbours and industry data as a substitute for transactional comparable data, especially as it relates to the Small and Medium Enterprises ("SME").

47. Our experience in the practical application of transfer pricing policies and providing evidence that the arm's length standard has been respected is that this has become a significant compliance burden on many businesses and has been particularly onerous for the SME as these businesses often do not have the resources or expertise to comply with transfer pricing requirements.

48. The compliance burden is an issue that is gaining prominence in recent years, with the complexity of transfer pricing issues, more aggressive assessments by tax administrations and the greater risk of double taxation. This issue is, more than ever, applicable to businesses of all sizes with the increased occurrence of globalization. Accordingly, we ask that the OECD reconsider its position on these two issues, the result of which could significantly alleviate the compliance burden for many businesses.

Revisions to Chapter I

49. The thrust of the changes in this Proposed Revisions, as summarized in the introduction, are:

    i. The hierarchy of transfer pricing methods;

    ii. Comparability analysis; and

    iii. Guidance on the application of transactional profit methods.

In that regard, most of the changes are reflected in Chapters II and III of the Proposed Revisions and there are few substantive changes proposed to Chapter I.

50. Chapter I contains some very important and fundamental principles that were debated in the Business Restructuring Discussion Draft[5] and Business Restructuring Consultation[6]. These principles include:

    i. realistically available options (para 1.34);

    ii. recognition of a transaction (para 1.35);

    iii. control over risks (para 1.47); and

    iv. commercially rational behaviour (para 1.63 to 1.68).

51. We propose that the revisions to Chapter I be postponed until the Business Restructuring Discussion Draft has been reviewed in light of business community feedback on these important issues, so that a complete revision to Chapter I can be issued.

Again, thank you for this opportunity to participate in this very important endeavour. We look forward to the next revisions.

Yours very truly,

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[5] "Business Restructuring Discussion Draft" refers to Transfer Pricing Aspects of Business Restructurings: discussion draft for public comment (September 2008).
[6] "Business Restructuring Consultation" refers to the consultation with business commentators on its discussion draft on the transfer pricing aspects of business restructurings held in June 2009.