

Mr. Jeffrey Owens
Director Centre for Tax Policy and Administration OECD
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08 January 2010

Dear Mr. Owens:

We, as members of TP Consulting are pleased to provide the following comments in response to the OECD Centre for Tax Policy and Administration's public invitation to comment on proposed revision of chapters I-III of the Transfer Pricing Guidelines, released on 09 September 2009.

We appreciate the opportunity to share our views on these chapters revised by the Working Party. We would also welcome the opportunity to provide further insight on these issues as you request. We have provided our individual contact information if you wish to contact any of us directly.

For clarity purposes we have organized our comments according to the presentation of your draft revision. We are pleased to authorize the OECD to publish our comments on its website or in any publications.

We hope that the below given comments will be useful in the further development of the Guidelines.

Yours sincerely,

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COMMENTS ON PROPOSED REVISION OF CHAPTERS I-III OF THE TRANSFER PRICING GUIDELINES

1. First Comment:

1.1.Reference:

- Page: 21
- Paragraph: 1.63

1.2.OECD Draft Wording:

“A tax administration’s examination of a controlled transaction ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them, using the methods applied by the taxpayer insofar as these are consistent with the methods described in Chapter II. In other than exceptional cases...”

1.3.Proposed Wording:

TP Consulting propose to add a sentence so the new paragraph should be:

“A tax administration's examination of a controlled transaction ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them using the methods applied by the taxpayer insofar as these are consistent with the methods described in Chapter II. **This tax administration’s examination should consider the impact on the company’s Profit and Loss statement.** In other than exceptional cases...” *(We had highlighted the sentence just to be clear with our proposal)*

1.4. Reasons for our proposal.

It is common that despite statement of arm's length principle, each country defines its own transfer pricing rules scope of application. In general, practice shows transfer pricing rules applies to related parties and/or transactions with companies located on tax havens. Some legislation could consider tax havens companies as related parties as a presumption of relation for tax purposes.

To fulfill transfer pricing duties companies usually hire special advisory in order to avoid tax penalties.

It has no sense that companies should follow transfer pricing duties if the transaction has no real impact on the profit and loss statement or if affects in a different period of time, according to accrual. For example, one company located on country "A", had acquired a service for \$ 1,000 from company "X" located on tax haven. According to A's transfer pricing country rules, all companies that perform transactions with tax havens companies should fulfill some specific transfer pricing duties. What happened if company "A" hadn't deducts this \$ 1,000 expense on its profit and loss statement? In this case it is clearly obvious that it has no sense for this company to fulfill transfer pricing duties. Even though the service hadn't follow arm's length principle, it is obvious that it has no impact on the profit and loss statement because the company hadn't deduct this \$ 1,000 for taxable income.

Another issue is presented when the transaction occurs only at the level of balance sheet statement, such as expenses reimbursement. In this case, it's recommended an additional analysis because this simple operation could be covering free services that must be analyzed as a different transaction.

2. Second Comment:

2.1. Reference:

- Page 60
- Paragraph: 3.30

2.2. OECD Draft Wording:

“A common source of information is commercial databases, which have been developed by editors who compile accounts filed by companies with the relevant administrative bodies and present them in an electronic format suitable for searches and statistical analysis. They can be a practical and sometimes cost effective way of identifying external comparables. A number of limitations to commercial databases are frequently identified. Because these commercial databases rely on publicly available information, they are not available in all countries, since not all countries have the same amount of publicly available information about their companies. Moreover, where they are available, they do not include the same type of information for all the companies operating in a given country because disclosure and filing requirements may differ depending on the legal form of the company and on whether or not it is listed.

Care must be exercised with respect to whether and how these databases are used, given that they are compiled and presented for non-transfer pricing purposes. It is not always the case that commercial databases provide information that is detailed enough to support the chosen transfer pricing method. Not all databases include the same level of detail and can be used with similar assurance. Importantly, it is the experience in many countries that commercial databases are used to compare the results of companies rather than of transactions because third party transactional information is rarely available. See paragraph 3.36 for a discussion of the use of non-transactional third party data.”

2.3. Proposed Wording:

TP Consulting propose to add a sentence, so the new paragraph should be:

“A common source of information is commercial databases, which have been developed by editors who compile accounts filed by companies with the relevant administrative bodies and present them in an electronic format suitable for searches and statistical analysis. They can be a practical and sometimes cost effective way of identifying external comparables. A number of limitations to commercial databases are frequently identified. Because these commercial databases rely on publicly available information, they are not available in all countries, since not all countries have the same amount of publicly available information about their companies. Moreover, where they are available, they do not include the same type of information for all the companies operating in a given country because disclosure and filing requirements may differ depending on the legal form of the company and on whether or not it is listed.

Care must be exercised with respect to whether and how these databases are used, given that they are compiled and presented for non-transfer pricing purposes. ***Special emphasis should be taken in the terminology used on these databases in order to avoid transfer pricing discussions or litigation merely for the interpretation of some words or concepts.*** It is not always the case that commercial databases provide information that is detailed enough to support the chosen transfer pricing method. Not all databases include the same level of detail and can be used with similar assurance. Importantly, it is the experience in many countries that commercial databases are used to compare the results of companies rather than of transactions because third party transactional information is rarely available. See paragraph 3.36 for a discussion of the use of non-transactional third party data.” *(We had highlighted the sentence just to be clear with our proposal)*

2.4. Reasons for our proposal.

Our practice has enabled us to see several cases where companies and Tax Administrations get into big transfer pricing litigation just because of the interpretation of a word or concept when using database information for external comparisons. This point is agree with paragraph 3.43 where comparables incorporated must have enough information for ensure transparency of the process.

For example, if Tax Administration of Country "A" uses database created by some Country "B" administrative/statistical department, in order to apply traditional transaction methods, some concepts must be clear for both sides. If this database considers all CIF data (Cost, Insurance and Freight, according to International Chamber of Commerce or Convention on Contracts for the International Sale of Goods), taxpayer as well as tax administration must share the same meaning of cost, insurance and freight.

Both Tax Administration and taxpayers faces the risk of invest a lot of time and resources on the discussion and/or litigation not for transfer pricing problem, but just for how they understand some concepts of a database. This problem also increases if parties have to prove their positions.

3. Fourth Comment:

3.1. Reference:

- Page 61
- Paragraph: 3.35

3.2. OECD Draft Wording:

"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.”

3.3. Proposed Wording:

TP Consulting propose to add a sentence at the end of the paragraph.

“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. **Tax administrators should give reasonable time and relevant information to taxpayers in order that they can analyze this data.**” *(We had highlighted the sentence just to be clear with our proposal)*

3.4. Reasons for our proposal.

It will be unfair if taxpayers could not have the time to make its defense and review this data. It is necessary that the tax administration provides the taxpayer of the relevant information used to do the analysis, in order that the taxpayer could exercise its right of defense.

4. Fourth Comment:

4.1. Reference:

- Page 61
- Addition of new paragraph, as another source of information

4.2. New paragraph:

TP Consulting propose include an additional source of information after paragraph 3.35:

“ 4. Independent organized markets

3.36 In case taxpayers used to perform all transactions only with related parties without intervention of independent ones and given lack of access to transaction between third parties, information of conditions and/or prices of a known independent organized market will be applied where relevant. These organized markets should fulfill basic issues as maintain historical record prices and be recognized as an independent source of obvious conditions of free trade. *(We had highlighted the sentence just to be clear with our proposal)*

4.3. Reasons for our proposal.

For commodities exporter countries is important to determine conditions of arm's length because nature of the products implied a minimum added value in its trade. Generally, MNE have representative / trading offices in these countries as a provider of basic raw material at first-hand. What sometimes means unbeatable conditions and prices for headquarters off shore, could ends in a potential contingency by low income recognition for commodity country. In this case, all information related to price setting and consideration of independent and organized public market information as commodity exchange and/or over-the-counter negotiations will be useful to validate arm's length conditions. It's not mandatory that board prices and negotiated prices will be the same, but it is recommended same starting point in the bargaining of final export price. Sometimes these transactions reflect imperfect back to back schemes, where imperfection is given by additional expenses as a mark-up over

the raw material. Compliance of arm's length principle is achieved by resorting to these commodity exchanges.

5. Fifth Comment:

5.1. Reference:

- Page 63
- Paragraph 3.42, fifth bullet point

5.2. OECD Draft Wording:

“• Other criteria to exclude third parties that are in peculiar situations such as start-up companies, bankrupted companies, etc. when such peculiar situations are obviously not appropriate comparisons.”

5.3. Proposed Wording:

TP Consulting propose to add a sentence at the end of the paragraph.

“• Other criteria to exclude third parties that are in peculiar situations such as start-up companies, bankrupted companies, etc. when such peculiar situations are obviously not appropriate comparisons. **If comparables exhibits negative results in its profit level indicators in more than one year, their rejection will depend on prior analysis of business cycle or market trend and not necessary by its negative business behavior.**” *(We had highlighted the sentence just to be clear with our proposal)*

5.4. Reasons for our proposal.

The use of multi year data is helpful in order to establish a better understanding of a business cycle in certain economic sectors. However third parties used as comparables which exhibits negative results not necessary should be rejected prima facie, but it can be solved widening years of sample or adjusting to a different business cycle. This may mean more work but we can exhaust our options before reject them.

6. Sixth Comment:

6.1. Reference:

- Page 68
- Addition of new paragraph

6.2. New paragraph:

TP Consulting propose include of additional paragraph after 3.66:

“Downturn circumstances: should be also considered the delayed effect of different geographical areas. Economic (and business) downturn doesn’t occur at the same time in best of the cases, so if the seasonability can be identified, it can be modeled in order to adjust results of comparables”. *(We had highlighted the sentence just to be clear with our proposal)*

6.3. Reasons for our proposal.

Financial data and price setting strategies of third parties comparables doesn't have the same fiscal year closure, so if they exhibit abnormal results it doesn't supposed to be extreme results, but are results of different seasonability. Economic business cycles information and interest rates will be useful to update and recreate market (even if it means a downturn) conditions.

7. Seventh Comment:

7.1. Reference:

- Page 70
- Paragraph 3.74

7.2. OECD Draft Wording:

“In practice, examining multiple year data is often useful in a comparability analysis, but it is not a systematic requirement. Multiple year data should be used where they add value to the transfer pricing analysis. It would not be

appropriate to set prescriptive guidance as to the number of years to be covered by multiple year analyses”

7.3. Proposed Wording:

TP Consulting propose to add a sentence at the end of the paragraph.

“In practice, examining multiple year data is often useful in a comparability analysis, but it is not a systematic requirement. Multiple year data **and multiple average** should be used where they add value to the transfer pricing analysis. It would not be appropriate to set prescriptive guidance as to the number of years to be covered by multiple year analyses **and multiple kinds of average according with situation**”. *(We had highlighted the sentence just to be clear with our proposal)*

7.4. Reasons for our proposal.

The use of multiyear data is due to timing issues. One is that the analysis of Transfer Pricing is a topic of determining income current tax, and the comparable companies are also in the same process and its current results are not published. In that case, it’s valid try to collect the sector’s profitability using multi year data, but in many cases will not capture the overall economic effect of the current year. Hence, it should be allowed the use of different averages (simple, weighted or moving average), even included in the projected year average, according to the overall trend of the sector and year analysis if this analyze add value.

8. Eighth Comment:

8.1. Reference:

- Page 80
- Paragraph 8: Addition of sentences in “Some observations” subtitle

8.2. OECD Draft Wording:

“• An issue in making working capital adjustments is what point in time are the Receivables, Inventory and Payables compared between the tested party and the comparables. The above example compares their levels on the last day of the financial year. This may not, however, be appropriate if this timing does not give a representative level of working capital over the year. In such cases, averages might be used if they better reflect the level of working capital over the year.

• A major issue in making working capital adjustments is the question of which interest rate to use. The rate to be used is determined by reference to an arm's length interest rate for the tested party. In most cases a borrowing rate will be appropriate. In cases where the tested party's working capital balance is negative (that is Payables > Receivables + Inventory), a lending rate may be considered in some cases. The example uses an interest rate based on what TestCo is able to borrow at in the local market. This example also assumes that the same interest rate is applied to payables, receivables and inventory.

• The purpose of working capital adjustments is to improve the reliability of the comparables. There is a question whether working capital adjustments should be made when the results of some comparables can be reliably adjusted while the results of some others cannot.”

8.3. Proposed Wording:

TP Consulting propose to add some sentences:

“• An issue in making working capital adjustments is what point in time are the Receivables, Inventory and Payables compared between the tested party and the comparables. The above example compares their levels on the last day of the financial year. This may not, however, be appropriate if this timing does not

give a representative level of working capital over the year. In such cases, averages might be used if they better reflect the level of working capital over the year. **E.g., in cyclical business like end-of- year based business, where intensive capital working is in the last quarter of the year, making impossible any distribution of the capital cost of proportion or their distribution in the year.**

- A major issue in making working capital adjustments is the question of which interest rate to use. The rate to be used is determined by reference to an arm's length interest rate for the tested party, **or at least the one which reflects their (weighted) cost of capital.** In most cases a borrowing rate will be appropriate. In cases where the tested party's working capital balance is negative (that is Payables > Receivables + Inventory), a lending rate may be considered in some cases. The example uses an interest rate based on what TestCo is able to borrow at in the local market. This example also assumes that the same interest rate is applied to payables, receivables and inventory; **however cost of capital structure is not fixed.**

- **Besides cost of capital structure variable, related parties usually make intercompany loans as a source of non-expensive financial leverage, so market conditions for a reasonable working capital adjustment should consider this issue too.**

- **Another structure issue is about segmented financial data. Some of third parties comparables have availability of segmented data based on line of business. To the extent that not all comparables have segmented data available and not all segmented line of business are governed by the same interest rate (cost of working capital), it should be possible establish an standardized weighted interest rate to increase working capital adjustment accuracy.**

- The purpose of working capital adjustments is to improve the reliability of the comparables. There is a question whether working capital adjustments should be made when the results of some comparables can be reliably adjusted while the results of some others cannot."

8.4. Reasons for our proposal.

Companies don't have similar working capital structure, even they belong to the same industry or economic sector. Some companies also are characterized by cyclical behavior in sales, profitability or structure of assets during time. A better approach considers working capital structure and segmentation of working capital where relevant and feasible to obtain.