**TruePartners**
CONSULTING

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Mr. Jeffrey Owens
Director
Organisation for Economic Co-operation and Development
Centre for Tax Policy and Administration
2, rue André Pascal
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France

Dear Mr. Owens,

True Partners Consulting, in cooperation with its global network of affiliates (collectively "True Partners International"), welcomes the opportunity to provide comment on the Organisation for Economic Co-operation and Development, Centre for Tax Policy and Administration *Proposed Revision of Chapters I-III of the Transfer Pricing Guidelines* ("Proposed Guidelines").

We believe the Proposed Guidelines provide a valuable service in improving and clarifying key provisions of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("TPG"). Choice of methods and comparability analysis lie at the heart of transfer pricing practice, and therefore every effort to clarify and rationalise the relevant provisions of the TPG is most welcome.

However, we feel the Proposed Guidelines miss the opportunity to make needed improvements and clarifications in the TPG. We are also concerned that certain provisions of the Proposed Guidelines, if implemented, may subject taxpayers to undue administrative burdens and taxing authority scrutiny.

We offer our comments in detail below.

Best Regards,

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1. Hierarchy of Transfer Pricing Methods

a) The provisions of the Proposed Guidelines relating to choice of methods would bring the TPG into closer conformity with the U.S. transfer pricing regulations (as provided by Section 1.482 of the U.S. Treasury Regulations) with respect to the determination of the most appropriate method. In language that is substantially similar to that provided by the U.S. regulations, the Proposed Guidelines provide that "[t]he selection of a transfer pricing method always aims at finding the most appropriate method for a particular case." With respect to multinational enterprises doing business in the U.S., this change would ease taxpayers' administrative burden by allowing them to use a single transfer pricing analysis to fulfill the requirements of both the U.S. taxing authorities and those of the TPG.

b) However, by bringing the TPG into conformity with the U.S. transfer pricing regulations, the implementation of the Proposed Guidelines could have the undesirable result of causing taxing authorities in other jurisdictions to view these changes as a concession to the U.S. taxing authorities' approach. This, in turn, could cause non-U.S. taxing authorities to hold a prejudicial view of transfer pricing studies prepared by U.S.-based practitioners. This could put the clients of U.S. practitioners at a relative disadvantage, and could thereby distort the market for professional transfer pricing services.

c) The Proposed Guidelines would no longer require that profit-based methods be used only as a "method of last resort." Generally speaking, this would be a welcome change. It could have the undesirable effect, however, of encouraging taxpayers to apply profit-based methods without properly weighing all of the methods, including traditional transaction methods, thereby leading to a further commoditization of studies applying the transactional net margin method.

2. Application of Transactional Net Margin Method ("TNMM")

a) The Proposed Guidelines provide further and clearer guidance on the application of the TNMM, including the use of tested party data, profit level indicators and calculation of net margins. However, sufficient guidance is not provided on the segmentation of tested party data, *i.e.*, the proper keys that can be used to allocate operating expenses.

b) The Proposed Guidelines state that the comparable profit split method should be used as a corroborative method in order "to avoid having a disproportionate amount of overall profit accruing to the tested party…" Whilst this approach is theoretically sound, in practise it may encourage taxing authorities to apply the profit split method not merely as a corroborative method, but rather to make assessments and adjustments where such

application would provide a favourable result for the taxing authority. Similarly, taxpayers could use this method to obtain a favourable result for themselves. More generally, the profit split method is not an arm's length approach, and therefore its application may undermine the OECD's commitment to the arm's length principle.

c) The Proposed Guidelines fall short in ensuring that governments do not use "secret" comparables. They provide that taxing authorities may use comparability data where such data is made available to the taxpayer. As a practical matter, however, this would not eliminate the possibility that the taxpayer would be at an unfair disadvantage vis-à-vis the taxing authority, as the taxpayer may not be able to conduct its own functional comparability analyses as effectively as it could if all relevant data were publicly available.

3. Comparability analysis

a) The proposed guidelines acknowledge that an exhaustive search of all possible sources of comparables is not required, and that such a search could represent a particularly burdensome exercise where there are limitations in the availability of information. However, the Proposed Guidelines do suggest that taxpayers and tax authorities should exercise judgement to determine whether particular comparables (described as "reasonably reliable comparables") are, in fact, reasonably reliable or whether there is a need to search for more reliable ones. This could give rise to a host of practical difficulties. Although the guidelines suggest the adoption a practical approach using prudent business management principles, it remains to be seen whether taxing authorities will respect such an approach.

b) The Proposed Guidelines state 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." This could provide tax authorities with the opportunity to unduly challenge the use of appropriately determined comparables determined by the taxpayer, giving rise to unnecessary and costly compliance burdens.

c) The suggestion that the arm's length principle should, where possible, be applied on a transaction by transaction basis presents a number of potential hazards. Taxing authorities could easily accept transactions that are in their favour whilst disputing those that are not even where, on a combined basis, the taxpayer's transaction falls within the comparable range.

d) The indication that adopting the transactional profit split method requires a functional analysis of both parties is potentially problematic, as taxpayers may effectively be forced

to provide information to a foreign tax authority which they may not have to provide local tax authorities. This information could unfairly be used to the detriment of the taxpayer.

e) In choosing the comparable set, the Proposed Guidelines refer to "well known players in the market," and "information on known competition." However, taxing authorities often reject reliance on such companies on the grounds that they are part of a multi-national group, and thus potentially under challenge on their transfer pricing position.

f) The Proposed Guidelines did not make use of the opportunity to reduce the administrative burden for smaller- and medium-sized entities where the potential exposure is relatively limited. The UK tax authorities have prudently adopted this approach, and it would have been desirable for the Proposed Guidelines to have followed suit.

4. Application of Transactional Profit Split Method

The Proposed Guidelines take a step into the right direction by placing the profit split method on more equal footing vis-à-vis the transactional transfer pricing method. Furthermore, the more detailed guidelines with regard to the application of the transactional profit split method provide useful guidance. This refers to both the question of how to measure the profit to be split, as well as how to split said profits, between the associated enterprises.

a) However, some key definitions are insufficiently detailed. For example, in Paragraph 2.60, the term "particular transaction" could have been defined more thoroughly. It also would have been helpful to have provided examples in Paragraph 2.64 to clarify what such contributions might look like. Paragraph 2.65 provides that the profits may be based on the division of functions between the associated enterprises. However, functions *per se* are not very useful for the attribution of profits, as functional analysis is only the first step in a qualitative description of the taxpayer's activities. The more important question concerns the outcome of this activity and how it contributes to the success of the transaction.

b) Paragraph 2.69 states that the guidelines do not seek to provide an exhaustive catalogue of ways in which the transactional profit split method may be applied. Practitioners would likely benefit from more detailed examples to see what is acceptable under the TPG. In Paragraph 2.73, some examples regarding the measurement of the relative value of the contribution would also have been valuable.

c) The remark in Paragraph 2.64, "[t]he more tenuous the nature of the external data used when applying the profit split method, the more subjective will be the resulting allocation of

profits," could be misleading under some circumstances. A profit split based on internal data could be more objective than a profit split based on external data.

d) With regard to paragraph 2.66, it is not clear whether other methods, except the TNMM, could also reflect the unique facts and circumstances of the associated enterprises. If, for example, a one-sided method like the cost plus or the resale minus method is used, the unique facts and circumstances could also be considered in the respective mark-up or resale gross margin, respectively.

e) Paragraph 2.71 states that it would be reasonable to expect the criteria or allocation keys to be agreed upon in advance of the transaction. In some cases it may be reasonable to agree on the type of allocation keys in advance.

f) Under Paragraph 2.81, it is not self-evident why projected profits, rather than actual profits, should be the basis for the profit split. Independent entities dealing at arm's length which apply the profit split would likely choose this method because they jointly bear the risk and earn the respective profit or loss. In many cases they share the outcome due to the high risk of the transaction. This means that independent parties would likely agree on the condition of splitting the actual profit in advance.

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