



January 12, 2010

## USCIB Comments on the OECD Proposed Revision of Chapters I-III of the Transfer Pricing Guidelines, September 9, 2009

The U.S. Council for International Business (“USCIB”) welcomes the comments proffered by the Secretariat to revise, update and ultimately improve the principles incorporated in Chapters 1 through 3 of the OECD Model Transfer Pricing Guidelines. USCIB believes the comments strike the proper balance between the need for tax administrations to properly enforce the cross border allocation of income within a MNE and the practical constraints faced by MNEs in complying with such requirements.

USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

Below, specific comments are provided where clarification or slight modification may wish to be considered by WP6 before finalizing the revisions.

- USCIB welcomes elimination of profit based methods as being used in only exceptional circumstances. USCIB agrees that choice of method should be based on the reliability of the data and strength of comparability. In particular, USCIB:
  - Agrees that if a profit-based method and a transaction-based method are equally comparable, the transaction-based method should be chosen as the most appropriate method.
  - Agrees that a CUP method should prevail over other methods when the CUP method can be more reliably used than the other methods.
- USCIB reaffirms and supports that the arm’s length standard should be retained and that the essence of the arm’s length standard is:
  - Recognition of transactions between commonly controlled entities as structured by the parties.
  - Potentially adjusting the results of such transactions to be consistent with the results of what independent parties entering into a comparable transaction under



comparable circumstances would have experienced even though such direct comparables may not, in fact, exist.

- USCIB agrees that no viable alternative to the arm's length standard exists and that global formulary apportionment or other alternatives would cause an unreasonably high risk of double taxation that would hinder international trade.
  - USCIB reiterates that global formulary apportionment should be distinguished from case specific contribution profit splits, such as have been used in financial service industry APAs or resolutions of MAP cases.
- USCIB cautions that tax administrations must exercise care in applying the concept of “alternatives reasonably available” as a comparability factor. In many cases, analysis of “alternatives reasonably available” has been used by tax authorities as a mechanism to effectively ignore transactions actually entered into by the controlled parties without first determining such disregard of the taxpayer's form is warranted.
- USCIB would encourage further guidance and clarification regarding the comparability of markets for the product or service being provided. In this context, the term “market” may include not only the level of the market, but also the essential characteristic of the market for the product or service being tested. For example, the type of market structure (*e.g.*, competitive as compared to oligopolistic) may materially affect a transfer pricing analysis. Comparison of markets is especially critical in today's economic environment because the current economic down turn is affecting many industries differently. One would not expect the same effect on profits of suppliers in an industry that experienced a 10% decrease in sales as one would expect in an industry that experienced a 50% or greater drop in demand. Similarly, one would not expect that suppliers in different industries would all recover at the same rate. The TNMM should not be used by tax authorities to impose taxable profits in circumstances where independent parties would have earned losses; similarly, one entity in a supply chain may earn a profit even though one or more related parties may earn a loss due to the economic circumstances they each face.
- USCIB applauds acceptance of multi-country/regional sets of comparables as a practical solution for MNEs that operate essentially similar types of operations in many regions around the world.

USCIB requests the comment in paragraph 2.6 regarding under-taxing highly profitable enterprises should be clarified. For example, the comment could be interpreted as meaning that a distributor should earn a higher profit than a comparable independent distributor even though the



higher combined profit of the enterprise was due to a unique intangible developed and owned by a member of the MNE group other than the controlled distributor; such a result should not follow.

- USCIB generally believes the discussion of an MNE’s obligation to create and maintain transfer pricing documentation strikes an appropriate balance. However,
  - USCIB believes the Guidelines at paragraph 3.3 should be modified to state that tax authorities should generally follow the method chosen by taxpayers that maintain and document a globally uniform transfer pricing policy for similarly situated entities, provide that the taxpayer can demonstrate the method was reasonably applied. For example, taxpayers that globally apply a TNMM with similar profit margins for similar reselling operations should not be required to provide segmented consolidated income statements and balance sheets to support potential application of a profit split method, unless the tax authority examining a local reseller has reason to believe that the taxpayer’s choice of the TNMM was not an appropriate method.
  - Annual updates for routine transactions should not be required as currently suggested in Par. 3.81.
  
- USCIB generally agrees with the new discussion of the profit split methods (paragraphs 2.70- 2.71), which potentially expands the use of the profit split methods. Application of the TNMM in some circumstances may fail to capture the unique market circumstances facing competitors within the tested party’s industry, with a high likelihood of non arm’s length results. Thus profit splits should not be limited to cases involving unique intangible assets, where unique is defined by reference to high or excess profits, rather than by reference to the ownerships of intangible assets by potentially comparable companies.
  
- USCIB encourages a statement that the Guidelines should be followed by tax authorities to in evaluating APA applications when the taxpayer identifies the potential conflict of the two countries domestic approaches. Application of the Guidelines at the APA evaluation stage would help to reduce the current backlog of CA or MAP cases or to shorten the time required to resolve bilateral APAs.
  
- USCIB further agrees that “profit split” methods may also be applied to split consolidated losses. This application of the profit split method is especially appropriate in the current economic situation where in most cases losses are occurring due to market forces, not the effects of improper transfer pricing.



USCIB applauds the discussion of the practical application of the profit split methods contained in new paragraphs 2.71- 2.98. These paragraphs provide specific and practical guidance that will likely encourage wider adoption of the profit split methods where appropriate.

- USCIB agrees that caution needs to be exercised in using cost based allocations to apply a profit split method to ensure that the value created through the expenditures is closely related to the cost. However, techniques exist to account for the differences in costs occurred among related parties and may be reliably applied in some cases.
  - For example, the cost to obtain regulatory approval to make and sell the same product in different markets may be much higher in one market than in another. If regulatory approval costs were 5 times higher in one market than another and the higher costs did not add to the value or improve the performance of the product, it would be improper to attribute a higher profit split percentage to the entity in the country with the high regulatory costs than to the entity in the lower cost country, all other factors being equal.
- USCIB applauds the expanded discussion of practical guidance for applying TNMM contained in paragraphs 2.110 to 2.148. In particular, USCIB:
  - Agrees that data sample size, mechanical application of asset intensity adjustments and the use of ranges (or parts of ranges) cannot take the place of facts and circumstances based comparability analysis.
  - Agrees that market factors and factors unique to the taxpayer's operations or industry need to be considered in order to avoid having TNNM used as a method to require some average level of taxable profit without regard to whether independent parties would not have earned the same level of profit in comparable circumstances.
  - Agrees that the absence of arguably unique intangibles should not mandate application of the TNNM, especially if the TNMM is based on using only published data from companies that are at best superficially comparable.
- USCIB suggests that Paragraph 2.120 be clarified regarding the term “exceptional or extraordinary circumstances of a non recurring nature” is used in an ordinary sense and not as defined by an accounting system.
- USCIB suggests the discussion of how foreign exchange risk enters into applying the TNNM be expanded. The current discussion deals with only a narrow type of foreign



exchange risk, the risk of gain or loss arising from an account receivable being denominated in one currency when the seller or the buyer has costs incurred, or revenues received, in another currency. A much more difficult issue that should be addressed in the Guidelines is the sharing of the broader economic foreign exchange risk that occurs when production cost are incurred in one currency and sales revenues are received in another currency. In such a case, the producer and reseller of the foreign made goods may be at a competitive advantage or disadvantage compared to a wholly domestic set of producers and resellers. In a purely competitive market, the costs of the lowest cost producer will eventually establish the market price putting higher cost producers (and their resellers) at a disadvantage. During the time period while these pricing adjustments are occurring, it would be improper to apply the TNMM by reference to “comparable” resellers (or producers) who were not experiencing similar foreign exchange related price adjustments. Certain simplified methods for sharing the economic effects of foreign exchange gains or losses have been agreed in bilateral APAs. It would be helpful if the Guidelines could describe acceptable and unacceptable methods for dealing with this complex issue.

- USCIB agrees with the statement that when TNNM is used by either the taxpayer or the tax authority, the process for choosing comparables and making comparability adjustments should be transparent. In addition, the description of the “additive approach” to selecting comparables found in paragraph 3.40 should be clarified to indicate that the approach does not encompass effort to “cherry pick” certain comparables because either the taxpayer or tax authority prefers the outcome based on selecting a few comparables that might not have been selected had the “deductive approach” been used. USCIB also welcomes the sections that describe the process for selecting TNMM comparables and making adjustments to the data derived from such searches.
- USCIB agrees with the observation in paragraph 3.42 that both quantitative and qualitative factors must be taken into account in selecting comparables. As the proposed Guidelines observe in paragraph 3.50, quantitative adjustments no matter how sophisticated and complex cannot overcome a lack of comparability.
- USCIB agrees with the observation in paragraph 3.63 that loss making comparables should not be systematically removed from a potential TNNM data set. USCIB has witnessed instances where exclusion of loss comparables together with use of an interquartile range are used as a basis for creating de facto minimum levels of taxable income for controlled parties when comparable uncontrolled parties would have incurred a loss.



UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

We appreciate the opportunity to participate in this process. We wish the OECD continued success in its efforts on this important topic.

For questions or further information please contact:

Lynda Walker  
Vice President and International Tax Counsel  
United States Council for International Business  
[lwalker@uscib-dc.org](mailto:lwalker@uscib-dc.org)