

CEA comments on the OECD discussion on the Transfer Pricing Aspects of Business Restructurings

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The CEA, the European insurance and reinsurance federation, is keenly interested in the OECD discussion on the Transfer Pricing Aspects of Business Restructurings. The CEA welcomes the opportunity to present its views and engage in the discussions with the OECD on this subject.

The Transfer Pricing Aspects of Business Restructurings - discussion draft for public comment (“Discussion Draft”) is an important starting point for further discussion of the often discussed and controversial field of transfer pricing that raises significant issues with tax authorities, namely the tax treatment of business restructurings in a group of associated companies.

In general, the CEA agrees with the comments of the Business and Industry Advisory Committee to the OECD (BIAC). As the voice of the European insurance industry, the CEA would, however, like to draw your attention to the following areas of specific concern:

(1) Particular insurance and reinsurance concerns on risk transfer and control

Especially in the fields of insurance and reinsurance, questions of risk transfer and control are of primary importance. From an insurance and reinsurance perspective, we would like to draw your attention to the following point:

- It must be accepted that risk is often – especially in insurance groups – coordinated and controlled centrally; eg, very often the ultimate parent company of a multinational insurance group sets guidelines regarding risk-taking, restricts risk-taking and controls insurance risks centrally. In such cases, allocating the business to the parent company that only executes a shareholder control function would not reflect economic reality.

(2) Double taxation issues

The overall target of transfer pricing rules in the field of business restructurings is to avoid double taxation or non-taxation of income. Nevertheless, the experience of recent years shows that, notwithstanding the OECD efforts, the risks of double taxation in transfer pricing questions in general, and in business restructurings in particular, have increased as a consequence of unilateral measures and extensive interpretations of rules by national tax authorities. In this context, the Discussion Draft should:

- clearly avoid any uncertainties or room for interpretation;
- address the question of reverse adjustments: mutual agreement procedures often take too long and seem to be rather ineffective. Therefore, the OECD should consider introducing a chapter explicitly stating the need for reverse adjustments in order to avoid any risk of double taxation as a consequence of extensive interpretation of rules by tax authorities. In order to avoid any negative impact on the industry in cases where the tax administrations interpret transfer pricing rules in different ways, any changes that could lead to double taxation may therefore only be made if the other state accepts a compensating adjustment.

(3) The role of synergies

In groups of multinational enterprises, the sole purpose of restructurings is often to create synergies within the group. These synergies may not only result in future profits and fewer costs, but also in avoiding future disadvantages/potential losses that might be incurred as a group that is not efficiently structured develops. Thus, a synergy realised in a restructuring might also secure the status quo of a group.

Taking this into account, the OECD approach to acknowledge synergies within a group as economic reasons for restructuring is adequate. With regard to the arm's length principle, a single company would only restructure if it created an individual advantage (or avoided a future disadvantage). Therefore, it must be made very clear in sec. 213, that it is not the restructuring itself that is subject to the third party comparison, but that the advantages obtained through the restructuring should be allocated to the single companies according to the arm's length principle. Accordingly, it is only the disadvantages resulting from restructuring that a third party would not have accepted without obtaining indemnification that have to be compensated for.

In other words, to comply with the arm's length principle, it should be sufficient for a restructuring to make sense from a group perspective and for possible disadvantages realised by single companies to be compensated.

(4) Compensation as a result of business restructuring/exit taxation

The Discussion Draft clearly states that profit/loss potential is not an asset, but a potential that might be carried by some rights or other assets (Sec. 64). *"Therefore, the arm's length principle does not require compensation for the loss of profit/loss potential per se."* Even if, according to the OECD, profit/loss potential might arise only in connection with rights or assets, it ultimately remains unclear in which cases the shift of profit potential is to be compensated and whether or not it might be part of or connected with a tangible or intangible asset or right and hence compensated. Therefore, it should be stated that profit/loss potential per se (which cannot be connected with a tangible or intangible asset or right) does not qualify as an "asset" ("goodwill" eg in the form of savings from lower production costs as a consequence of cheaper labour, better infrastructure or tax savings). As the group is free to structure itself in an efficient manner, when it is set up, it must be free to restructure (without indemnification) if the economic surroundings offers savings opportunities.

(5) Application of the guidance at paragraphs 1.36-1.41 of the TP Guidelines

The CEA generally agrees with the OECD approach according to which contractual arrangements are the basis for the allocation of risks, but a reclassification of a transaction may be made in "exceptional cases" (reference to 1.36 and 1.37 of the TP Guidelines). The TP Guidelines allow for reclassification under two circumstances:

- where the economic substance of a transaction differs from its form (re-characterising in accordance with the substance)

- where, while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those that would have been adopted by independent enterprises behaving in a commercially rational manner

In order to avoid discrepancies in interpretation, it should be clarified what “exceptional cases” actually relate to the context of business restructurings. Moreover, clear boundaries in the scope for interpretation of the expression “commercially rational manner” should be fixed for tax administrations. In particular, this means that the non-recognition of a transaction should be limited to pure tax avoidance schemes. In general, tax authorities should therefore rely on how the entrepreneur assessed a transaction, as he has the best insight into his business, the business environment and opportunities.

(6) Documentation requirements

The documentation requirements seem too extensive to the CEA. In particular it is necessary to document, for example, possible alternatives, the consequences of the alternatives, comparability analysis pre-restructuring and post-restructuring for the alternatives as well, and so on. Notwithstanding this necessity, ultimately, documentation cannot be decisive in determining the arm’s length price, as this would lead to an approach which puts form before substance and includes hindsight information/ better knowledge. Therefore, even though documentation seems to some extent necessary, a consensus should be achieved that the target of these requirements should be streamlined documentation and as little bureaucracy as possible and not “adding up” all the documentation requirements currently required by a number of jurisdictions around the world.

This position paper sets out the CEA’s preliminary remarks on the Discussion Draft. The CEA would like to reserve the right to refine these comments at a later stage.

The CEA is always available and happy to assist the OECD with regard to all the issues mentioned above, as well as any other questions that arise in the course of discussion.

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The CEA is the European insurance and reinsurance federation. Through its 33 member bodies, the national insurance associations, the CEA represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. The CEA, which is based in Brussels, represents undertakings that account for approximately 94% of total European premium income. Insurance makes a major contribution to Europe’s economic growth and development. European insurers generate premium income of €1 122bn, employ one million people and invest more than €7 200bn in the economy.