SVENSKT NÄRINGSLIV
CONFEDERATION OF SWEDISH ENTERPRISE

OECD Centre on Tax Policy and
Administration
Director
Mr. Jeffrey Owens

Position Paper: Confederation of Swedish Enterprise – Comments on the OECD Discussion Draft entitled "Proposed Revision of Chapters I-III Transfer Pricing Guidelines 9 September 2009 – 9 January 2010"

Dear Jeffrey,

The Confederation of Swedish Enterprise is pleased to provide comments on the OECD Discussion Draft entitled "Proposed Revision of Chapters I-III Transfer Pricing Guidelines 9 September 2009 - 9 January 2010".

The Confederation of Swedish Enterprise welcomes the initiative by the OECD on the hierarchy of transfer pricing methods to replace the current status of transactional profit methods as a last resort method to a standard whereby the selected transfer pricing method should be the most appropriate method to the circumstances in the case.

We also welcome the effort by the OECD to improve and provide more detailed guidance on comparability analysis. It is however important that the guidelines do not require companies to make an unnecessary extensive analysis on comparability. Companies should only be required to make a best effort.

The Confederation of Swedish Enterprise supports the comments made by BIAC but would, in addition, like to provide a few comments on comparability.

Comparability analysis

General comments

Comparability is at the heart of every transfer pricing analysis and a more detailed guidance is well needed.

The Confederation of Swedish Enterprise finds that the Draft of the revised Chapters I-III of the OECD Transfer Pricing Guidelines overall is a well balanced product

aiming to provide further guidance in the areas of comparability and the practical application of profit methods.

However, considering that transfer pricing is not an exact science and that, in practise, it is virtually impossible to meet all comparability standards, it is important to emphasize that the Guidelines should be viewed as indications as to what aspects to consider when performing a comparable search, rather than as standards that must be met.

Normally, it is the taxpayer who comes up with the first analysis of the transactions at hand. If the taxpayer has presented a reasonable and sound analysis of those transactions and also, when selecting comparables, given due consideration to the comparability factors, then the taxpayer has a justified expectation to be able to rely on that analysis. The tax authorities should not reject the entire analysis simply because another method could have been used.

If one of the comparability factors poses particular problems to the taxpayer, he is of course probably well advised to specifically address that issue and to present his line of reasoning in that context.

The Confederation of Swedish Enterprise is of the opinion that the comparability requirements must be dealt with in a pragmatic and proportional way in the context of what constitutes a reasonable effort by the taxpayer, given the facts at hand and the circumstances in the particular case.

In general, the Confederation of Swedish Enterprise would like the Guidelines to further stress that tax authorities must act responsibly and apply a pragmatic approach towards good faith efforts performed by taxpayers in this context. The Confederation of Swedish Enterprise nevertheless believes that the more detailed guidance would be welcomed by taxpayers.

Specific comments

Paragraphs 3.2 and 3.3

Paragraph 3.2 and 3.3 in the draft guidelines read as follows:

"3.2 As part of the process of selecting the most appropriate transfer pricing method (see paragraph 2.1) and applying it, the comparability analysis always aims at finding the most reliable comparables. This does not mean that there is a requirement for an exhaustive search of all possible sources of comparables as it is acknowledged that there are limitations in availability of information and that searches for comparables data can be burdensome. See also discussion of compliance efforts at paragraphs 3.79-3.82. For this reason, the phrase "reasonably reliable comparables" is used in these Guidelines to refer to the most reliable comparables in the circumstances of the case, keeping in mind the above limitations.

3.3 This does not, however, imply a safe harbour. 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."

The expression "reasonably reliable comparables" can be found in at least 18 paragraphs in the draft Guidelines (1.13, 1.38, 1.53, 2.1, 2.3, 2.62, 2.64, 2.73, 2.86, 2.139, 2.144, 3.2, 3.29, 3.31, 3.34, 3.36, 3.37 and 3.80).

First of all, it seems odd to give a term, which is used so many times throughout the entire document, a meaning other than the general meaning of the term. In general, it is difficult to argue that "reasonably reliable" has the same meaning as "the most reliable".

Secondly, if comparables are found to be "reasonably reliable" (disregarding the definition proposed in paragraph 3.2) it is hard to understand why or how these comparables disqualify as "reasonably reliable" only because "more reliable" comparables are found. An outcome based on "reasonably reliable comparables" (again disregarding the definition proposed in paragraph 3.2) should be acceptable even if "more reliable comparables" are subsequently found. The proposed definition in paragraph 3.2 creates a "circular reasoning" making it virtually impossible to know whether "reasonably reliable comparables" (meaning "the most reliable comparables") have been found and used. This results in an unacceptable high degree of uncertainty for taxpayers.

Furthermore, paragraphs 3.2 and 3.3 send a strange message to taxpayers. From paragraph 3.3 it follows that the use of reasonably reliable comparables does not imply a safe harbour. It is difficult to see the rationale behind imposing a requirement for the use of the most reliable comparables and then stating that even if the most reliable comparables are used, an adjustment can be made. Can there be any more reliable comparables than the most reliable comparables? If not, then how come that the use of the most reliable comparables does not create a safe harbour?

Paragraphs 3.2 and 3.3 could be understood as stating that even if a taxpayer applies and follows the Guidelines, uses reasonably reliable comparables and arrives at an outcome which is reasonably accurate, the taxpayer can still be subject to an adjustment. The Confederation of Swedish Enterprise is of the opinion that this could effectively undermine the status of the Guidelines. Why follow the Guidelines if there is no benefit in doing so?

The reasoning in 3.3 also stands in contrast with the spirit of the wording in other parts of the Guidelines;

- 1.13:"/…/ It should also be recalled at this point that transfer pricing is not an exact science but does require the exercise of judgement on the part of both the tax administration and taxpayer."
- 3.54: "/…/ transfer pricing is not an exact science /…/"
- 2.110: "/…/ Determining a reliable estimate of an arm's length outcome requires flexibility and the exercise of good judgment /…/"

Finally, it is hard to understand the logic in having a statement requiring the use of "the most reliable comparables" while at the same time stating that there is no requirement for an exhaustive search of all possible sources of information. Considering that transfer pricing is a core issue for companies, the need for predictability and clear guidance in this area is essential. Without it, the risk of unresolved double taxation in many cases is obvious.

For these reasons, the Confederation of Swedish Enterprise proposes a revision of the draft to ensure that a comparability analysis based on "reasonably reliable comparables", as it is understood under the general meaning of the phrase, will be respected by tax authorities. This should apply even if additional comparables are subsequently found. Accordingly, we recommend that paragraph 3.3 is deleted and that the language of paragraph 3.2 is revised to provide as follows:

> "3.2 As part of the process of selecting the most appropriate transfer pricing method (see paragraph 2.1) and applying it, the comparability analysis always aims at finding the most reliable comparables. This does not mean that there is a requirement for an exhaustive search of all possible sources of comparables as it is acknowledged that there are limitations in availability of information and that searches for comparables data can be burdensome. See also discussion of compliance efforts at paragraphs 3.79-3.82. It should also be kept in mind that transfer pricing is not an exact science but does require the exercise of judgment (see paragraph1.13)"

Paragraph 3.32

The statement in 3.32 that quantity should not be encouraged over quality is a sound statement. However, it needs to be recognized that generally there are no perfect comparables available and hence Tax Administrations should use caution when questioning comparables used by the tax payers if these have been selected in good faith following an appropriate analysis. Statements emphasising that the same prudent behaviour, when selecting and reviewing comparables, need to be observed by tax administrations would be welcomed. It is e.g. rare that an analysis made by tax administrations is transparent, systematic and repeatable. However, it is not rare that a tax administration challenges a "best effort analysis" (which should be seen in the light of the fact that transfer pricing is not an exact science and it is very rare that, following a comparability study, including functional analysis, perfect comparables exist) prepared by a taxpayer by simply "rejecting" the use of certain comparables.

Paragraph 3.61

Under the proposed changes in the Guidelines, if not all observations are equally reliable, this may call for a need to consider the use of statistical tools (e.g. inter-quartile) to improve reliability. If all observations are reliable, the use of the full range seems appropriate. However, according to the new 3.61, it may be appropriate to use measures of central tendency (median) in determining the point to which an adjustment (by the tax administration) is made where comparability defects remain. The Confederation of Swedish Enterprise This finds this statement to be contradictory to the ALP. Why would a central tendency be more appropriate than any other point in the range (and specifically a point within the range that better

reflect the actual result of the taxpayer)? We believe that this statement could be used by several tax administrations to routinely make adjustments to the median rather than another point in the range (upper or lower end of the range), something which would be highly negative for the business community, not to say contradictory to the principles established in the Guidelines. This would also make the MAP more difficult. In our opinion, such an outcome is unacceptable.

Paragraph 3.69

The fact that the arm's length outcome testing approach (3.69) would rarely be applied between third parties does not seem to be acknowledged in the Guidelines. In addition, to the extent year-end adjustments (or compensatory adjustments) are performed before year-end closing rather than after year end closing, in connection with the tax return submission, it would in many cases increase the possibility for the taxpayer on the other side of the transaction to account for this adjustment rather than resorting to the MAP. Such an outcome would be beneficial to both taxpayer and tax administrations. We believe this is worth emphasising since the statements in 3.69 seem entirely focused on adjustments in connection with preparing the tax return.

Paragraph 3.72

The language suggested in 3.72 in relation to "ex post" adjustments is very welcome and could actually serve as a model for a more general guidance in this context.

Penalties

The use of penalties is becoming more frequent by various Tax Administrations and may for example be directed towards the existence (or non-existence) of transfer pricing documentation, timely filing or in some cases the mere fact that an adjustment (even if not due to negligence by the tax payer) is made. Although Chapter IV (4.18-4.28) to some extent addresses this issue we believe that further statements in connection with the discussion on comparability adjustments would be welcome, e.g. by emphasising that penalties should not be levied in cases where a taxpayer has performed a reasonable and sound analysis and documented such an analysis in an appropriate way. It is not acceptable that Tax Administrations use penalties to influence the decision by tax payers with respect to the allocation of taxable profits between countries.

On behalf of the Confederation of Swedish Enterprise

8 January, 2010

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