DIAGEO

GREAT BRITAIN

Lakeside Drive
Park Royal
London
NW10 7HQ

Tel +44 (0)208 978 6000
Fax +44 (0)208 978 8506

8 January 2010

Mr Jeffrey Owens
Centre for Tax Policy and Administration
OECD

Dear Mr Owens

Proposed Revision of Chapters I-III of the Transfer Pricing Guidelines
9 September 2009 – 9 January 2010

We welcome the opportunity to input into the revision of Chapters I-III of the Transfer Pricing Guidelines and outline in the following letter our observations on the consultation draft issued.

This is clearly a critical area for all Multinational Enterprises and we are committed to ensuring we achieve a relevant, current and appropriate set of guidelines that achieve the tax policy objectives of the OECD without creating unduly onerous compliance burdens for business.

General Comments

Firstly let me confirm our endorsement of your intention to update the current guidelines to take account of the comments and experiences of the business community to ensure they are appropriate and fit for purpose both now and going forward.

Generally we believe the proposed draft to be a step forward, specifically with regard to creating a more level playing field between the traditional transaction and transactional profit methods. We fully support this approach and indeed would seek to clarify further that a taxpayer is entitled to select the most appropriate method in a reasonable manner without the need to consider the other methods in detail (i.e. that there should be no need to prove the negative). Whilst the current draft suggests the former it is not clear on the latter, i.e. that it should not be necessary to work through the methods not selected just to reinforce the choice of the actual method used.

As long as the rationale for choosing the method in question is reasonable and clearly documented our view is that this should be sufficient as anything further would be unduly onerous.

With regard to the selection of Profit Level Indicators ("PLIs") the draft includes some helpful examples and clearly states that those used are not exhaustive, it does however set a tone as to what types of PLIs may be preferred. As per the above, we believe that as long as the rationale for the choice made is reasonable and clearly documented this should be sufficient.

With regard to the selection of comparables, whilst we agree they need to be of sufficient comparability to the transactions in question to be of use, we are concerned at the ever increasing level of precision comparability being required by tax authorities. Whilst the current draft does acknowledge that no comparable will be perfect it does not provide enough clarity as to what is reasonable. Furthermore, some of the detailed suggestions for adjustments to ensure comparability require an unrealistic level of analysis/information gathering of the taxpayer.

Specific Observations

Chapter I – The Arm's Length Principle

Para 1.5, We agree that evidence of hard bargaining alone does not establish that dealings are necessarily at arm's length. Indeed we would go further and say that it is very clear that the process of bargaining that exists between independent parties cannot be expected to be replicated within multinational groups where this would not fit with standard business practice. Moreover what is important is that the outcome reached is in accordance with what would have been agreed between independent parties acting at arm's length.

Para 1.7, Where you refer to the "re-writing of accounts", can you confirm what this term means? We expect that you are actually referring to adjustments for tax purposes rather than the re-issuing of statutory accounts, but would request your clarification on this point.

Para 1.11, Building on the point re para 1.5 above we fully agree with the last sentence of this section concluding that the fact that a transaction may not be found between independent parties does not necessarily mean that it is not arm's length. In our experience however this is not an area where there is alignment between tax authorities and would therefore suggest that this wording be strengthened to be clear that a transaction cannot be disregarded purely on the basis that it may not be found between independent parties.

Para 1.63 and 1.64, The wording for para 1.63 remains relevant and appropriate in limiting the re-characterisation of transactions to only those cases that are exceptional. However the definition of what constitutes exceptional, specifically that relating to the second circumstance of what independent enterprises behaving in a commercially rational manner may have concluded remains too wide and open to interpretation. Certain tax authorities will attempt to use this as a test of comparability and if a near identical third party transaction cannot be found will seek to invoke this, which we believe is not what the guidelines intend, specifically in light of the acknowledgement of a lack of perfect comparables and the point made at para 1.11.

Para 1.78, We note that there are still certain territories where the direct and indirect tax authorities do not co-operate and this can make the effective management/compliance of Customs Duty and Transfer Pricing obligations particularly difficult. Whilst the draft does acknowledge this, anything further that could be done between the OECD and WTO/WCO to promote higher levels of co-operation would be beneficial.

Chapter II – Transfer Pricing Methods

Para 2.7, Whilst this section is a welcome addition, we believe it needs to be clearer in establishing what is required to effectively evidence the choice of method. Specifically we believe this should focus on the positive (justifying the method of choice) rather than the negative (explaining why the other methods were not selected). This should meet the reasonableness test without being unduly onerous on the taxpayer.

Para 2.11, The draft in this section is not clear. We disagree that the use of a secondary analysis may suggest that the primary method is not appropriate. We consider that a secondary analysis which supports the outcome of the tested party (in line with the primary method) can be seen as further corroboration that the pricing is indeed arm's length. Conversely, where a secondary method does not corroborate the primary method, this may be further evidence that it is not the appropriate method in that case and actually provides further confirmation to the taxpayer that the primary method selected is indeed the most appropriate. In either case we believe the draft needs to be far clearer in what it is concluding about the use of secondary analysis.

Chapter II, Part III – Transactional Profit Methods

Para 2.61, In Joint Venture and certain third party scenarios we do not believe that it is that unusual for the target profit of each party to be set as a condition of the overall transaction. As such it may be appropriate to re-draft this statement accordingly.

Para 2.70, Whilst we welcome the acknowledgement of the transactional profit split method as an equally appropriate alternative, the current draft does suggest a narrow set of circumstances where this may be applicable and we do not necessarily agree that the examples suggested are the only circumstances where it may apply. Furthermore it is not clear how a taxpayer would be expected to evidence that the profit split is consistent with that which would be agreed between third parties. Greater clarity is required here to prevent tax authorities adopting divergent interpretations of this guidance.

Chapter III – Comparability Analysis

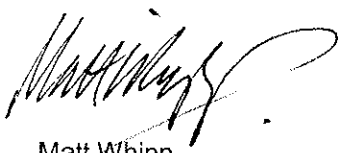
Para 3.2, We agree with the spirit of this section in acknowledging that the intention is always to find the most reliable comparables whilst acknowledging that there is often no perfect answer. However the term "reasonably reliable comparables" requires further definition as in our experience tax authorities are attempting to employ ever higher standards of comparability which are making the burden of proof on the taxpayer unrealistic. This point is supported by para 3.37 where it is acknowledged that comparables will not be perfect, but need only to be reasonable. In order to ensure a more consistent interpretation of this section by tax authorities we need to have a clearer definition of what "reasonable" means.

Taking into account the above, whilst this draft represents a significant step forward in updating the guidelines, there is still a great deal of uncertainty in their potential interpretation by tax authorities. We would therefore suggest further dialogue is required in order to set greater clarity on the key issues for multinationals.

I trust that the above is clear, however, should you require further clarification on any point please do not hesitate to contact me.

In the meantime, I look forward to the next stage in the consultation process.

Yours sincerely



Matt Whipp
Head of Business Risk and Transfer Pricing
Diageo Plc