Comments on the proposed revision of the Transfer Pricing Guidelines;
Chapter I-III.

1 In regards to the sixth sentence in (old paragraph1.27) paragraph1.49 in the revision, which states;

"When addressing the issue of the extent to which a party to a transaction bears any currency exchange and/or interest rate risk, it will ordinarily be necessary to consider the extent, if any, to which the taxpayer and /or the MNE group have business strategy which deals with the minimization or management of such risks., Hedging arrangements, forward contracts, put and call options, etc, both on-market and off-market, are now in common use. Failure on the part of a taxpayer bearing currency exchange and interest rate risk to address such exposure may arise as a result of a business strategy of the MNE group seeking to hedge its overall exposure to such risks or seeking to hedge only some portion of the group's exposure."

The concept refers to the hedging arrangement against potential currency exchange risks between the time of contract and the final settlement.

Currency exchange risks arise largely from unpredictable fluctuation in med/ long-term exchange rate behavior. The above paragraph does not specify solutions to such challenge. Fluctuations in currency exchange rates may result in losses of the MNE group as a whole.

The MNE group does not have a business strategy to avoid mid/long term currency exchange risks.

Proper method of management of such risks in dealing with transfer pricing cases should be addressed.

2 In regards to (old paragraph 1.52) paragraph 1.69 in the revision, which stipulates "Losses"; the paragraph states "When an associated enterprise consistently realizes losses while the MNE group as a whole is profitable, the facts could trigger some special scrutiny of transfer pricing issues". The paragraph does not stipulate "losses" while the MNE group as a whole experiences deficit.

Profits generated by one associated enterprise, while the MNE group as a whole is in red, would result in deficit expansion of other associated enterprises.

Indication of deficit consolidation in dealing with transfer pricing cases is recommended.

3 In regards to the stipulations of the effect of government policies in (old paragraph 1.55~1.59) paragraph 1.72~1.76 in the revision;

The paragraph does not seem to address definite resolutions of the issues concerning government policies.

It should be clearly defined that the government policies are beyond taxpayers' control, and, thus, such policies and transfer pricing regulations should be considered totally independent of each other.

It is impossible to relieve conflicts in government policies and reach a mutual agreement between two countries (for example between Japan and China) even by enforcing transfer pricing regulations and mutual agreement procedures.

4 Paragraph 2.3 in the revision gives two examples of "the transactional profit method, which might be the most appropriate method", which include; "presence of significant unique intangibles contributed by each of the parties to the controlled transaction or the engagement in highly integrated activities makes a transactional profit split more appropriate than a one-side method" and "where these is no or limited publicly available reliable gross margin information on third parties, traditional transaction methods might be difficult to apply in cases other than those where there are reasonably reliable comparables, and a transactional profit method might be the most appropriate method in view of the availability of reasonably reliable information".

However, transfer price should basically be determined through comparable uncontrolled transactions.

Results obtained both by adjusting comparables and by applying transactional profit method should be compared to validate reliability.

The third sentence in paragraph 3.9 in the previous edition stated that "independent enterprises do not ordinarily use the profit split method to determine their transfer pricing".

I would like to know the reason behind the decision to opt out the stipulation from the revision.

Paragraph 2.87 in the revision, which defines an "allocation key", states "Depending on the facts and circumstances of the case, the allocation key can be a figure (e.g. a 30%-70% split based on evidence of a similar split achieved between independent parties in comparable transaction), or a variable (e.g. relative value of participant's marketing expenditure or other possible keys as discussed below)".

An accurate allocation key can neither be obtained from open market nor be established through variables.

The fear is that, with arbitrarily recognized allocation keys, the approach will have similar qualities with those of a global formulary apportionment method, which was not formerly supported by OECD.

Therefore, a transactional profit slip method should only be applied as a last resort.

5 Paragraph 2.75 in the revision, which defines Residual analyses, states “in the second stage, any residual profit (or loss) remaining after the first stage division would be allocated among the parties based on an analysis of the facts and circumstances, following the guidance as described at paragraph 2.86 – 2.99 for splitting the combined profit”. The definition allows residual profit split method to be applied to both residual profit and loss.

Clear definition on residual profit split method applicable to residual “Loss” should be provided.

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