TAX EXECUTIVES INSTITUTE, INC.

12 January 2010

Mr. Jeffrey Owens
Director, Centre for Tax Policy & Administration
Organisation for Economic
Co-operation and Development
2, Rue André Pascal
75775 Paris
France

Via email: jeffrey.owens@oecd.org

Re: *Discussion Draft of Proposed Revisions of Chapters I-III of the OECD Transfer Pricing Guidelines*

Dear Mr. Owens:

On 9 September 2009, the Committee on Fiscal Affairs (CFA) of the Organisation for Economic Co-operation and Development (OECD) released a consultation document setting forth a proposed revision of Chapters I-III of the 1995 Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereafter "the guidelines" or "the TP Guidelines"). The discussion draft is a result of the OECD's ongoing monitoring and implementation of the 1995 TP Guidelines and reflects a critical review of the guidance in light of a decade and a half of experience in applying the rules. On behalf of Tax Executives Institute, I am pleased to respond to the OECD's request for comments.

TEI Background

Tax Executives Institute was founded in 1944 to serve the professional needs of business tax professionals. Today, the organization has 54 chapters in Europe, North America, and Asia. As the preeminent international association of business tax professionals, TEI has a significant interest in promoting tax policy, as well as in the fair and efficient administration of the tax laws, at all levels of government. Our 7,000 members represent 3,200 of the largest companies in the United States, Canada, Europe, and Asia.

Discussion Draft Background

The discussion draft of the proposed revision to Chapters I-III builds upon the work of the CFA's Working Party No. 6, incorporating the discussion drafts on the theoretical foundations of comparability analysis released in May 2006 and on transactional profit methods released in January 2008, as well as the results of the public consultation on both drafts. The principal proposed changes to the 1995 TP guidelines are, as follows:

1. The current TP guidelines have two categories of recognised transfer-pricing methods: the traditional transaction methods (comparable uncontrolled price (CUP), resale price, and cost plus) and transactional profit methods (transactional net margin method (TNMM) and profit split method). Currently, the transactional profit methods are to be applied on an "exception" basis as a method of last resort where no or insufficient data are available to apply the traditional methods. The proposed guidelines would replace the "exceptional" standard for application of transactional methods with a requirement that the transfer pricing method be the "most appropriate method to the circumstances of the case."

2. The current guidance on comparability analysis in Part C of Chapter I of the TP guidelines has been revised and supplemented with a new Chapter III providing detailed guidance on the comparability analysis, including a recommended 10-step process for performing the analysis.

3. Additional proposed guidance on the application of the transactional profit methods, including the application of the profit split method and the comparability standard to be applied when using TNMM, was developed and added as Part III of Chapter II of the guidelines. Three new Annexes were developed to illustrate the application of the transactional profit methods and to provide an example of a working capital adjustment made to improve comparability.

Executive Summary

TEI commends Working Party No. 6 for reviewing and updating the 1995 TP Guidelines. Based on the experiences of taxpayers and tax administrations, the proposed revisions generally clarify the application of the guidelines and should enhance the efficacy of the arm's length principle for cross-border transactions generally and, hence, reduce controversies between taxpayers and tax administrations about the proper arm's length price (or results) in specific cases.

TEI supports the OECD's decision to de-emphasise the hierarchy of transfer pricing methods in favour of a requirement that taxpayers apply a method "most appropriate" to the facts and circumstances of each case.

TEI also supports a reaffirmation of the principle that a tax administration's examination of a controlled transaction should ordinarily be based on the transaction actually undertaken by the associated enterprises as it was structured. We offer several specific recommendations to clarify the proposed guidelines to ensure they are consistent with this principle.

Although the revisions to the TP Guidelines are generally helpful and provide much needed clarification, TEI is concerned that some of the changes are ambiguous and may spawn new controversies or exacerbate uncertainty. For example, some changes may encourage tax administrations to reject regional or worldwide comparables selected by taxpayers in favour of local market products or services even where such products or services are *not* truly comparable to the taxpayer's regional or global products or services. In addition, while the guidance in paragraphs 2.2 to 2.6 on the selection of the most appropriate transfer pricing method is welcome, TEI believes that tax administrations may (as a result of guidance in Chapter II, Part III, such as paragraph 2.63) inappropriately assert the existence of "unique intangibles" or "highly integrated operations" in order to apply the transactional profit split method. Thus, we recommend revisions be made to encourage tax administrations to make appropriate adjustments to the taxpayer's TNMM method to ensure comparability rather than encouraging the assertion of the existence of unique intangibles (or highly integrated operations) and substitution of the transactional profit split method for TNMM.

Finally, TEI is concerned about the increased documentation burdens and costs the discussion draft would impose on business taxpayers. Government representatives at the public consultations on the Allocation of Profits to a PE under Article 7 and Business Restructuring acknowledged that enhanced documentation is not a panacea for all problems in tax administration. Nevertheless, the discussion draft maintains the trend of recent OECD guidance by increasing documentation requirements. For example, although the proposed guidelines state that taxpayers are under no obligation to perform multiple pricing analyses to establish the comparability of their pricing method to what independent parties would have done under the circumstances,[1] other statements and references[2] can be read to require multiple analyses of pricing methods thereby increasing taxpayer documentation burdens. In addition, paragraph 3.81 suggests that an *annual* comparability analysis must be performed for all but the simplest transactions. TEI believes that, in the absence of a material change in circumstances, comparability analysis updates should be required no more than once every three years. A number of other recommendations are also provided to ease taxpayer documentation burdens.

Specific comments on various paragraphs of the discussion draft are, as follows:

The Arm's Length Principle

1. *Burden of Proof.* Paragraphs 1.6 to 1.13 describe the arm's length principle. Paragraph 1.6 states that Article 9 paragraph 1 of the Model Convention, which forms the basis of bilateral treaties between OECD member countries, sets forth the authoritative statement of

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[1] For example, paragraph 3.2 states that there is no requirement for an "exhaustive search of all sources of comparables."

[2] For example, paragraph 2.1 states that the selection of a method should take account of the strengths and weaknesses of *each* method and paragraph 2.11 suggests that a secondary method can be used to "corroborate" the arm's length nature of the prices). Paragraph 2.7 states that "finding the most appropriate method . . . does not mean that *all* the transfer pricing methods should be analysed *in depth* or tested in *each case* . . . ." The italicized words imply that an analysis of other methods or comparables would be necessary in some cases, but there is no guidance for determining when such analysis would be required.

the arm's length principle, as follows:

> [When] conditions are made or imposed between . . . two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

Because the separate entity approach treats the members of a multinational enterprise (MNE) as if they were independent entities, the nature of the dealings between the members and the conditions must be examined to determine whether the conditions differ from those in comparable uncontrolled transactions. The analysis of the controlled and uncontrolled transactions is referred to as the "comparability analysis." Paragraph 1.7 cautions that the comparability analysis must balance the reliability of the analysis with the burden imposed on taxpayers and tax administrations. Paragraphs 1.12 and 1.13 expand on the need for balance since both taxpayers and tax administrations will often be challenged to find data to support an arm's length outcome based on "reasonably reliable comparables."

The introductory comments on the arm's length principle, the role of comparability analysis, and the balancing of taxpayer and tax administration burdens are appropriate and welcome. TEI believes the comments would be enhanced by discussing the role of the burden of proof in tax examinations and litigation. Under the guidelines and the domestic laws of most member countries, taxpayers have an affirmative obligation to document the arm's length nature of their controlled prices and conditions. Where the taxpayer provides the necessary data and documentation to establish that its prices are more likely than not arm's length, the taxpayer should be accorded a rebuttable presumption that its prices satisfy the arm's length principle with the burden of proving otherwise shifting to the tax administration.

TEI's recommendation is *not* that a safe harbour be accorded to the taxpayer's comparability analysis. Rather, the guidelines should include a procedural rule for determining who has the burden of proving that the prices and conditions are (or are not) arm's length and when that burden shifts. Specifically, if the taxpayer fails to establish that its prices are arm's length, the tax administrator may then undertake to prove what independent parties would have done. Where the taxpayer establishes that it has undertaken a reasonable comparability analysis to establish arm's length prices, however, the tax administrator should be precluded from substituting a different price without first proving that uncontrolled third parties would *not* have agreed to the taxpayer's selected method.

2. *Factors Determining Comparability*. Paragraph 1.36 sets out five attributes or "comparability factors" that establish the degree of comparability between controlled and uncontrolled party transactions, including the characteristics of the property or services transferred, the functions performed by the parties (taking into account assets used and risks assumed), contractual terms, the economic circumstances of the parties, and the business strategies pursued by the parties. Although we agree that the five attributes are relevant and

should be considered in most cases, there are circumstances where only some attributes need to be considered. For example, for commodity goods (or financial transactions relating to commodity-related dealings) where a comparable can be determined by reference to published market quotations or similar public benchmarks, only two attributes might be relevant in the analysis (characteristics of the property or services transferred and the contractual terms). Thus, although paragraph 1.37 acknowledges that "the extent to which each of these matters in establishing comparability will depend upon the nature of the controlled transaction and the pricing method adopted," the guidelines should include examples (*e.g.*, purchases or sales of commodities or commodity-related financial transactions) clarifying when and how the relevant factors are taken into account "as necessary under the circumstances."[3] Specifically, TEI recommends that the OECD insert the following two sentences after the first sentence of paragraph 1.37:

> For example, some commodity goods and financial transactions (shares, options, forward and futures contracts, *etc.*) have widely published market quotations and standardised terms and conditions whereby a price consistent with the open market can easily be determined and where only two attributes might be relevant in the analysis (*e.g.*, similarity of characteristics of the property or services transferred and similarity of the contractual terms). For such intercompany transactions, the need to investigate other comparability factors may be irrelevant or unnecessary.

Finally, in order to reduce taxpayer documentation burdens, we recommend that paragraph 1.37 also include a statement that "these transfer pricing guidelines provide suggestions for finding comparables but are not intended to provide prescriptive rules for every case."

3. *Routine vs. Non-routine Transactions.* Paragraph 1.53 states that "[i]nformation on third party contractual terms may be less critical if the controlled transaction is, for example, the provision of back-office accounting services and the comparison made is with the price of similar services offered by accounting firms." We agree that routine, low-value services do not require as much documentation of comparability as non-routine transactions or services. We encourage the OECD to expand this principle and apply it to other areas in the five-factor comparability analysis rather than limiting it to the analysis of contractual terms. Minimising the number of steps in the comparability analysis for low-value or routine transactions would help reduce taxpayer documentation burdens.[4]

[3] Foreign exchange markets are also public, liquid and terms and conditions are highly standardised.

[4] To reduce controversy and minimise documentation burdens, some countries have provided explicit guidance on the treatment of low-value services. *See, e.g.*, Rev. Proc. 2007-13, 2007-3 I.R.B. 295 (January 16, 2007), for the approach in the United States.

4. *Economic Circumstances.* Paragraph 1.56 states, as follows:

> The geographic market is another economic circumstance that can affect comparability. The identification of the relevant market is a factual question. For a number of industries, large regional markets encompassing more than one country may prove to be reasonably homogeneous, while for others, differences among domestic markets (or even within domestic markets) are very significant.

Paragraph 1.57 elaborates that "where similar controlled transactions are carried out by an MNE group in several countries and where the economic circumstances in these countries are in effect reasonably homogeneous, it may be appropriate for this MNE group to rely on a multiple-country comparability analysis." But "where an MNE group offers significantly different ranges of products or services in each country, and/or performs significantly different functions in each of these countries (using significantly different assets and assuming significantly different risks), and/or where its business strategies and/or economic circumstances are found to be significantly different . . . the recourse to a multiple-country approach may reduce reliability."

While paragraphs 1.56 and 1.57 seem inarguable, tax administrators frequently challenge a taxpayer's comparables by asserting that its regional or global products or services are not comparable to uncontrolled domestic market products or services. The globalization of trade, however, has led to an increase in the standardization of products that are only minimally adapted to local market tastes and preferences. Moreover, the European Union generally — and the EU's Joint Transfer Pricing Forum specifically — promotes a pan-European approach to product standards and transfer pricing. We submit that where the risks, assets, and functions of an MNE are consistent across a specific regional or global market, an MNE should be permitted to use regional or global comparables in its analysis. MNEs should not be required to undertake a domestic comparability analysis simply because the tax administration can point to *a* somewhat similar local product. Local products are rarely of the same quality or quantity as the MNE's products and thus only infrequently are they a reliable comparable. In addition, once taxpayers have established why global or regional comparables are used, tax administrations should, before requiring the use of local comparables, be required to prove why the results from the taxpayer's comparables are different from what arm's length parties would have agreed to. In other words, a difference in the outcome between local comparables and regional or global comparables should not, by definition, mean that the global or regional comparables used by the taxpayer are wrong.

In addition, the ambiguity of key phrases and terms, especially in paragraph 1.57, may lead tax authorities to require domestic comparables. We recommend that the following key phrases in paragraph 1.57 be clarified: "different ranges of products or services," "performs significantly different functions," "significantly different assets and assuming significantly different risks," and "where business strategies and/or economic circumstances are found to be significantly different."

Finally, to allay concerns about the uncertainty engendered by the economic circumstances factor and to underscore TEI's recommendation in respect of paragraphs 1.56 and

1.57, we recommend inserting the phrase "at a local, regional, or global level" at the end of the final sentence of paragraph 1.41. As revised, the sentence would state, "Before broadening the search to very large categories (*e.g.* industry codes), thought should be given to what other types of products are likely to offer the closest comparables to the taxpayer's transaction *at a local, regional, or global level.*"

Transfer Pricing Methods

Paragraph 2.1 of the draft guidelines provides that "the selection of a transfer pricing method always aims at finding the *most appropriate* method for a particular case." For this purpose, the method —

> should take account of the respective strengths and weaknesses of *each* of the OECD recognised methods; of the appropriateness of the method considered in view of the nature of the controlled transaction, determined in particular through a functional analysis; of the availability of reasonably reliable information (in particular on uncontrolled comparables) in order to apply the selected method and / or other methods; and of the degree of comparability of controlled and uncontrolled transactions including the reliability of comparability adjustments that may be needed to eliminate differences between them. (Emphasis added.)

This paragraph represents one of the significant changes in the guidelines because it de-emphasises the preference for the traditional transaction methods (*i.e.*, comparable uncontrolled price (CUP), resale price, and cost plus) over the transactional profit methods. Yet, paragraph 2.2 states that where "a traditional transaction method and a transactional profit method can be applied in 'an equally reliable manner,' the traditional transaction method is preferable . . . ." Although TEI supports the OECD's goal of de-emphasising the hierarchy of methods, it is unclear when methods can be applied in an "equally reliable manner." Where more than one method can be applied in "an equally reliable manner," taxpayers should be permitted to use any of the "equally reliable" methods without adjustment. At a minimum, the OECD should provide guidance on *what* should be compared and *when* such comparisons should be made in order to determine whether multiple methods can be applied in an "equally reliable manner." That guidance should either be included directly in the TP Guidelines or incorporated by reference to other guidance, such as the *Report on the Attribution of Profits to Permanent Establishments*.

Paragraph 2.10 confirms that the arm's length principle does not require the application of more than one method for a given transaction (or set of transactions) and "undue reliance on such an approach could create a significant burden for taxpayers. Thus, these guidelines do not require either the tax examiner or the taxpayer to perform analyses under more than one method." We concur and welcome the statement. Paragraph 2.11, however, states that "where a secondary method is used to corroborate a primary method, its purpose is to identify unusual outcomes that might suggest the need to further review the selection and application of the primary method to confirm whether or not it is the most appropriate to the circumstances of the case." To minimise confusion and potential taxpayer burdens, we recommend that paragraph 2.11 be eliminated. If paragraph 2.11 is retained, we recommend that the OECD substitute "verify" for "identify" in paragraph 2.11 and confirm that secondary methods are recommended only *when* the outcome under a primary method is unusual and not to determine *whether* the outcome is unusual.

Transactional Profit Methods

1. *Applying the Transactional Profit Split Method.* The proposed guidelines re-name the profit split method as the transactional profit split method. Because of the emphasis on selecting the "most appropriate method" to the circumstances, the transactional profit split method is no longer a method of last resort. Moreover, the proposed guidelines provide more guidance on when and how to apply the transactional profit split method.

Although TEI welcomes the additional guidance on the manner in which the transactional profit split method is to be applied, we are concerned that the elevation of the method will lead to requests from tax authorities to obtain information about related party results and profits in other countries in order to apply the method. If the taxpayer demonstrates that another method (*e.g.*, a CUP, cost plus, or TNMM applied to the local tested party) is appropriate to the circumstances, it should not be required to respond to broad, unfocused document requests from tax authorities to review what profits are reported in every jurisdiction.

In addition, paragraph 2.63 outlines the strengths and weaknesses of the transactional profit split method and states that the method "can offer a solution for highly integrated operations for which a one-sided method would not be appropriate," citing certain instances of global trading of financial instruments as an example. The paragraph also notes that it would be appropriate to use a transactional profit split where *both* parties "contribute unique and valuable assets (*e.g.* intangibles)" because independent parties at arm's length might wish to share profits in proportion to their contributions. To minimise confusion, the OECD should emphasise that the reference to "integrated operations" in paragraph 2.63 should not be misinterpreted to imply that *all* MNE intercompany activities are highly integrated. This can be achieved by including a cross reference to paragraphs 120-121 of Part III, Section C of the *Report on the Attribution of Profits to Permanent Establishments*, which provides a detailed description and analysis of when operations should be considered "highly integrated."

Finally, MNEs frequently reorganise and restructure in order to centralise management, distribution, sales, research activities, *etc.*, or make other efforts to streamline costs and functions. Such transactions should not give rise to a presumption that the transactional profit split method should be applied after the fact to the reorganised group. As paragraph 2.63 concludes, the profit split method should "not be used where one party to the transaction performs only simple functions and does not make significant or unique contributions . . . ." We agree. Where simple functions are present in the tested party and no CUP is available, the cost plus, resale profit, or TNMM methods should ordinarily be employed. An expansion of the use of the transactional profit split through an assertion by the tax authorities of "valuable intangibles" where there are none or through the assertion of the "highly integrated" nature of the MNE's operations in inappropriate circumstances would lead to an increase in documentation requirements as well as a misapplication of the arm's length principle. If applied in an untethered fashion to situations where arm's length parties would not ordinarily agree to split profits, the results of the transactional profit split method would resemble a formulary apportionment method.

2. *Applying TNMM*. Paragraphs 2.100 to 2.103 provide general guidance on when the transactional net margin method should be used. Paragraphs 2.110 through 2.142 provide detailed requirements for the selection of a profit level indicator as well as for the definition of net profit for comparability purposes. Finally, the revised guidelines expand on the requirements to undertake a functional analysis of both the tested *and* the non-tested party to a transaction.

TEI believes that the overall effect of the proposed revisions to this section is to impose more stringent requirements on the use of TNMM. Indeed, paragraph 2.150 states that "there are *concerns* that the safeguards established for the traditional transaction methods may be overlooked in applying the transactional net margin method." Although the discussion draft does not state what parties expressed the concerns, we believe that taxpayers generally welcome TNMM as a pragmatic, fact-based approach for identifying comparable transactions, functions, and risks and determining a proper arm's length result. Hence, we regret that the proposed requirements would unduly restrict the use of TNMM. TNMM is often the most appropriate method, especially for transactions involving intercompany provision of goods and services that do not involve unique intangibles and where third party gross profit margins are not available. Where the taxpayer's analysis under TNMM provides a reasonable approximation of the arm's length result, the taxpayer's results should be respected.

Comparability Analysis

Whereas the 1995 TP Guidelines provide general principles for determining the comparability of controlled transactions with uncontrolled arm's length transactions, Chapter III of the proposed revision sets forth very detailed rules and expands the requirements substantially. Indeed, according to paragraph 3.1 of the draft guidelines, the search for comparables is only part of the overall comparability analysis.

The goal of the comparability analysis is to identify "*reasonably* reliable comparables." Regrettably, while paragraph 3.2 confirms that an "exhaustive search" for all comparable data is not necessary because of limitations on the availability of information as well as the burdens of searching for data, the proposed guidelines do not address how extensive the search for comparables must be in order to be "reasonable." Since reasonable efforts to find a comparable does not mean that the taxpayer has established a safe harbour, clearer guidelines would be appreciated.

At the heart of the new rules for performing a comparability analysis is a ten-step process set forth in paragraph 3.5. The process is "not compulsory" because "the outcome is more important than the process (*i.e.* going through the process does not provide any guarantee that the outcome will be arm's length, and not going through the process does not imply that the outcome will not be arm's length). However, it is considered good practice to follow this or a similar process." TEI welcomes the statement that the process is not compulsory. As long as the process remains aspirational rather than prescriptive (*i.e.*, describing good taxpayer practices rather than requiring adherence to the steps in order to satisfy domestic law documentation requirements), it will be helpful. If member or non-member states require strict adherence to the approach, taxpayer burdens will increase without any assurance of better results.

In addition to the foregoing general comments, we have the following specific recommendations:

1. Since there is no definition for a "reasonably reliable comparable" and since "reasonable efforts" to identify comparables will not establish a safe harbour, TEI reiterates its recommendation that the guidelines include a procedural rule identifying when the burden of proving a comparable is deemed initially satisfied by the taxpayer and the burden shifted to the tax administrator to establish that the taxpayer's method is not a comparable or is insufficiently comparable.

2. Paragraph 3.3 states that "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." Taxpayer's reasonable efforts to find comparables, however, should generally shield the taxpayer from documentation and adjustment-related penalties. Thus, TEI recommends adding a third sentence to paragraph 3.3, as follows: "However, such efforts will shield taxpayers from documentation and adjustment-related penalties."

3. Paragraph 3.20 of the guidelines provides, in part:

> . . . while one-sided methods (*e.g.* cost plus, resale price or transactional net margin method which are discussed in detail in Chapter II) only require examining a financial indicator or profit level indicator for one of the parties to the transaction (the "tested party" as discussed in paragraphs 3.18-3.19), some *qualitative information* on the comparability factors and in particular *on the functional analysis of the non-tested party is also needed* in order to appropriately characterise the controlled transaction and choose the most appropriate transfer pricing method.

The nature, scope, and amount of "qualitative information" for the functional analysis of the non-tested party will affect the documentation burdens imposed on taxpayers. Hence, TEI recommends that additional definitions and guidance be supplied in the guidelines. In addition, the functional analysis of the non-tested party will be affected by the taxpayer's ability to obtain foreign-based data. The guidelines should acknowledge that the taxpayer is not obligated to obtain foreign-based data where the information is not relevant, where the taxpayer is not in control of the foreign party, or where legal restrictions would prohibit the disclosure of the foreign-based data.

4. Paragraph 3.23 notes that transfer pricing analysis necessitates that some information be available about foreign associated enterprises. Where the taxpayer does not control the foreign associated enterprise, however, it will be extremely difficult to obtain the desired information. We recommend that paragraph 3.23 be limited to cases where the taxpayer

owns directly or indirectly more than 50 percent of the foreign associated party.

5. Paragraphs 3.30 to 3.33 discuss the uses of commercial and proprietary databases to establish comparables. Paragraph 3.33 states that where a taxpayer uses an adviser firm's proprietary database to establish comparables, the tax administration "may request access to the database for obvious transparency reasons."

Where a taxpayer uses a commercial database, the taxpayer should be under no obligation to supply the tax administration with a subscription to that database. Tax administrations should obtain their own subscriptions to assess the quality of the commercial database. In respect of proprietary databases, the OECD should clarify the phrase "request access to the database." The tax administration's access to the proprietary database should be no more extensive than the taxpayer's access and no more than necessary to confirm the taxpayer's results. In no event should the tax administration have unbridled access to conduct its own searches without purchasing access from the owner. Indeed, the taxpayer may not, because of confidentiality restrictions imposed by the database owner, be able to provide any more data than the provider accords to the taxpayer. Hence, more guidance on the obligations and role of the database vendor and the taxpayer would be helpful.

6. Paragraph 3.35 notes that tax administrations may have access to comparable information based on examinations of other taxpayers. The paragraph cautions against the use of "secret comparables" unless the tax administration is able, within the limits of its confidentiality requirements, to disclose the data to the taxpayer so that it can defend against an adjustment. Regrettably, the revised guidelines permit the use of secret comparables in evaluating a taxpayer's prices as long as they are disclosed to the taxpayer so that it can defend itself. Taxpayers, however, are not in a position to know or utilize a "secret" comparable at the time they set their prices. Unless information is publicly available when the taxpayer is setting its prices, it should not be used against the taxpayer. Hence, we recommend deleting the second sentence of paragraph 3.35 and inserting the following: "The use of secret comparables for taxpayer assessments is not permitted because the taxpayer could not have known or used the information." If the second sentence of paragraph 3.35 is retained, the following sentence should be added to that paragraph: "Information that cannot be disclosed to the taxpayer should not be used for imposing penalties."

7. Paragraph 3.66 states that "[t]here are timing issues in comparability with respect to the time of origin, collection and production of information on comparability factors and comparable uncontrolled transactions that are used in a comparability analysis." Paragraph 3.67 notes that some taxpayers "establish transfer pricing documentation to demonstrate that they have made reasonable efforts to comply with the arm's length principle at the time their intra-group transactions were undertaken (hereinafter 'the arm's length price-setting' approach), based on information that was reasonably available to them at that point. Such information includes not only information on comparable transactions from previous years, but also expectations about market trends." Under paragraph 3.69, other taxpayers "might be required to test the actual outcome of their controlled transactions to demonstrate that the conditions of these transactions were consistent with the arm's length principle (hereinafter 'the arm's length outcome-testing'

approach). Such test[ing] typically takes place as part of the process for establishing the tax return at year-end." Finally, paragraph 3.70 states that both approaches "are found among OECD member countries." TEI recommends that the OECD clarify that the two methods are equally acceptable. Where a taxpayer has reasonably implemented either a price setting or price testing methodology where adjustments are made as required, that should be sufficient. As important, the OECD should clarify that where one country requires the use of the post-year end adjustment approach, the other country is under an affirmative obligation to provide a correlative adjustment under Article 9 paragraph 2 of the Model Convention in order to ensure that the same profits are not taxed by two different countries. The taxpayer should have access to the mutual agreement procedures, including arbitration, to ensure relief.

8. Paragraphs 2.84 and 3.73 state that tax administrators should refrain from the use of hindsight to adjust the pricing of taxpayers' controlled transactions. We concur. Transfer prices should generally reflect what was known or reasonably foreseeable at the time transactions were entered into. We recommend that paragraphs 1.60 to 1.62 be similarly clarified to admonish tax authorities not to use hindsight in evaluating business or marketing strategies.

9. Paragraph 3.81 implies that, except for the simplest transactions in a stable business and economic environment, taxpayers should undertake a full comparability analysis of all intercompany transactions on an annual basis. Comparability analyses, however, are extremely time consuming and requiring an annual comparability analysis of the scope and extent implied in paragraph 3.81 (and Chapter III of the guidelines generally) is substantially disproportional to the benefits for tax administration. Consequently, TEI recommends that paragraph 3.81 be revised to state: "In the absence of material changes affecting pricing conditions, taxpayers are not required to refresh their comparability analyses for any intercompany transactions more frequently than once every three years."

10. Paragraph 1.7 of the proposed guidelines notes that paragraph 1 of Article 9 of the OECD Model Tax Convention —

> is the foundation for comparability analyses because it introduces the need for a comparison between conditions . . . made or imposed between associated enterprises and those which would be made between independent enterprises, in order to determine whether a re-writing of the accounts of associated enterprises is authorised under Article 9 of the OECD Model Tax Convention (see paragraph 2 of the Commentary on Article 9).

Paragraph 3.17 states:

> [a] taxpayer may seek on examination a reduction in a transfer pricing adjustment based on an unintentional over-reporting of taxable income. *Tax administrations in their discretion may or may not grant this request. Tax administrations may also consider such requests in the context of mutual agreement procedures and corresponding adjustments* (see Chapter IV).

Where one jurisdiction accrues less than the proper amount of arm's length profit, another jurisdiction (or jurisdictions) obviously accrues (accrue) more than the proper share of the profit. Article 9, paragraph 1 of the Model Tax Convention (as well as other treaty provisions, such as the non-discrimination clause, mutual agreement procedure, *etc.*) should provide an implicit basis for relief from double taxation, but taxpayers are often denied relief unless a treaty provision comparable to paragraph 2 of Article 9 explicitly affords correlative adjustments. Since treaties for some jurisdictions do not include a provision similar to paragraph 2 of Article 9, we recommend that the guidelines generally (*e.g.*, paragraph 1.7), and paragraph 3.17 specifically, include a statement that tax administrations should ordinarily provide correlative adjustments similar to those accorded by Article 9 paragraph 2 of the Model Tax Convention.

Conclusion

TEI appreciates this opportunity to present its views on the discussion draft of the proposed revisions to the OECD's Transfer Pricing Guidelines. These comments were prepared under the aegis of TEI's European Direct Tax Committee whose Chair is Johann H. Müller. If you have any questions about the submission, please contact Mr. Müller at +45 3363 4374 (or johann.muller@maersk.com), or Jeffery P. Rasmussen of TEI's legal staff at +1 202 638 5601 (or jrasmussen@tei.org).

Respectfully submitted,

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cc: Johann H. Müller