

PROPOSED REVISION OF CHAPTERS I-III OF THE TRANSFER PRICING GUIDELINES

MEDEF's comments

General comments

We welcome this new wording of the Chapters I to III of the guidelines. The proposal is the result of an impressive work from the drafters for the clarification and larger specification and the many stage of consultation.

We have noticed and appreciated the permanent reference to the arm's length principle as it is presented in art. 9 of the Model Convention, i.e. with reference of what independent parties would have done in such circumstances. Such a principle must override the process of comparison which is only an imperfect way to approximate the behaviour of independent parties.

We also appreciate the frequent mention of "*facts & circumstances*" in the text, which is highly relevant for a matter such as transfer pricing.

We have noticed that in some places it is stated that the election of the most appropriate method belongs to the enterprise and that the tax authorities should first examine the method elected. We think it could have been emphasized times more while specifying that the tax authorities should follow the enterprise's choice. It is only when the authorities are able to evidence that the enterprise's choice is inappropriate that this choice can be challenged. Moreover, in such case the administration should be in a position to demonstrate its selected choice as the most appropriate with a full set of functional analysis and compliant with what independent parties would have done in the same circumstances.

We strongly regret that the exclusion of secret comparables has not been made clearer in this project: although we understand that OECD considers the use of secret comparables as not acceptable, the project remains sometimes ambiguous on that specific point (see §3.33 & 3.35).



As a conclusion we consider that the OCDE paper is very helpful. In the attached annex you will find our detailed suggestions on the text.

ANNEX

Chapter I

The Arm's Length Principle (paragraph numbers are the new ones)

1.5: The last sentence which was suppressed was useful. It is important to stress in the Guidelines the fact that MNE's very often use the transfer prices to set their business accounting that provide them with a measure of the performance of the several subsidiaries or business units.

1.11: We strongly support the last sentence that has been added. It is indeed important to highlight that transactions that do not exist between independent parties can however exist between related parties and still be arm's length.

1.13: The fact that there is no reliable or pertinent comparables should not allow the tax administration to impose a profit split. As a basic principle the tax administration should never impose its own method to a tax payer.

1.35: The adding in the second sentence is welcomed because it does not only refer to the price but also to the conditions in accordance with the text of art.9.

1.40: We do agree with the penultimate sentence which brings back to the analysis of comparability, not limited to the level of price but extended to the characteristics of the product and the functions associated with it. Such principle must be stressed on.

1.41: In the second sentence, the broadening of scope of the comparability analysis should only be done if it matches facts and circumstances.

Chapter II

Transfer pricing methods

We agree with the removal of the last resort qualification of the transactional profit methods introduced by the project.

We also would like to stress on the fact that the Guidelines, it results from their name, should remain a guide which aims is to help the enterprises to determine their transfer prices. As this matter highly depends on facts and circumstances, we consider that it is necessary to introduce flexibility any time the situation imposes it (see §2.119, 2.131, 2.132).

2.63: We suggest to rewrite the penultimate sentence as follows : " On the other hand , a *transactional profit split method would ordinarily not be used in case where one party to the transaction performs only simple functions and does not make any significant contribution **or even does not assume a significant part in the risks** (e.g. contract manufacturing or contract service activities in relevant circumstances), as in such cases a transactional profit split method typically would not be appropriate in view of the functional analysis of the party*". The selection of method between traditional methods and profit methods should be respected.

2.64: The statement in the last sentence is obvious; however the "subjective" qualification seems negative. This should not be the case as in the same circumstances independent parties would effectively follow a 'subjective' approach.

2.71: In the second bullet point, equal reference is made to the enterprise and the tax administration. We agree that the tax administration should be prepared to explain the appropriateness of the transactional profit split method it uses. However, it should also be required to evidence that the choice of the enterprise does not respect the arm's length principles and is inappropriate and that its choice is more appropriate than the method selected by the enterprise.

2.75: We consider that the contribution analysis & the residual analysis are not exclusive; in the second stage of the residual analysis the allocation of the residual profit may also be based on a contribution analysis in relation with 'an analysis of the facts & circumstances...'

2.79: The change in international accounting standards must be addressed: a compulsory change of standards by the MNEs should be viewed as still coherent as long as the new standards are consistently applied by the MNE.

2.84: The first sentence is confusing and should be suppressed.

2.87: The second sentence should be written as follow: "Depending on the facts and circumstances of the case, the allocation can be a figure (e.g. a 30% - 70% split based on evidence of a similar split achieved what would have been settled between independent parties in comparable transactions), or a variable ...". In most cases there is no exact comparables available.

2.88: The second sentence should be rewritten: "Other allocation keys can be used by the enterprises when such keys proves adapted to the facts & circumstances, such as those based for instance on incremental sales, headcounts (number of individuals involved in the key functions that generate value to the transaction), time spent by a certain group of employees if there is a strong correlation between the time spent and the creation of the combined profits, salary of certain group of employees, number of servers, data storage, floor area of retail points, etc. are also sometimes encountered". Allocation keys used should be the actual allocation used by enterprise and not result in enterprise having to use allocation key that it does not use in conducting its business. What is done by enterprise should be respected.

2.90: The first sentence refers to the choice of the method whereas it should only focus on the effect of the method; it should accordingly be rewritten: "When the profit split methods has been elected as the most appropriate method because both parties to the transaction contribute significant unique intangibles, then difficult issues appear in relation both to the identification of the intangibles and to their valuation".

2.91: We think that the use of keys based on expenses should be limited to very specific cases and we agree on the requirement of a '*strong correlation between relative expenses incurred and relative value added*'. Consequently we do not think that the examples are useful: the link between advertising expenses and the creation of intangible assets is very disputable (the notion of marketing intangibles is itself disputed), the link between the amount of R&D expenses and the value of newly created of IP assets is loose too. Therefore we do not recommend providing such examples.

2.96: In the second sentence: "...some analytic work is needed for the tax payer to draw a 'transactional' balance sheet ..."; we do not think that a balance sheet is necessary, neither feasible (a balance sheet requires a full accounting table, including working capital which is, very difficult to project); a simple summary of the valuated relevant assets is feasible and helpful for this purpose.

2.97: We would remove the words: "**time spent** by a certain group of employees". This measurement is not realistic because time sheets are not used in most companies.

2.99: The following part of the sentence should be removed: "and, in any event, other profit split methods should be considered before electing its use", because as a starting point, there should be a presumption that the method selected by the enterprise will is the most appropriate method.

2.100: In the fourth sentence, the following word and reference should be added "**earns in effectively comparable uncontrolled transactions (cf 3.25 à 3.29)** »

2.101: The transactional net margin method is likely to be reliable when both parties to a transaction use unique intangibles if these intangibles are not similar or have different value. It can happen that an entity produces or distributes products, for example in a specific regional area, and has developed

marketing intangibles or know-how which become a fundamental requirement to generate an important business margin. Moreover, profit split methods can in specific circumstances be difficult to apply. Under these conditions, TNMM can appear more appropriate. TNMM can also require adjustments. Moreover, in paragraph 2.101 the "bilateral method" is mentioned: it might be more appropriate to say "*bilateral or multilateral method*" insofar as profit split methods may involve more than two economical entities.

2.102: In the case where all parties have unique intangibles, transactional method or TNMM can be applied with adjustments.

2.103: If TNMM is appropriate when there are no significant intangibles, § 2.103 is not necessary.

2.104: The first sentence seems in contradiction with article 9 when it devaluates the notion of price.

2.107: The following sentences should be removed: "*to make a valid application of the method*" and "*Tax administrators may have more information available to them from examinations of other taxpayers. See paragraph 3.35 for a discussion of information available to tax administrators that may not be disclosed to the taxpayer, and paragraphs 3.66-3.78 for a discussion of timing issues*". It should not allow the use of information that cannot be shared with enterprises. If they were maintained it's an open door for tax administration to use secret comparables.

2.108: We do not understand why the **one-sided** characteristic of a method should be considered as a problem.

We think that the corroboration of a method by another one should be exceptional and specifically regarding a profit method that is used only in particular situation, according to facts and circumstances.

2.112: The second sentence seems in contradiction with the previous paragraphs.

2.116: Concerning the last sentence, it should be noted that it does not apply only to the TNMM but to all methods.

2.119: In the second sentence, after "*should be excluded*", the words "**when possible and relevant**" should be added.

2.125: Determination of inclusion of such items in the determination of the net profit margin for applying the TNMM should be based on what is done by enterprise in the course of its business, as decision to include or exclude an item should be pertinent to the business under review and may vary from one business to another.

2.131: In the third sentence, after the words "*should not be included*", the words "**when possible and relevant**" should be added because some sales may not be included as being de minimis and having no real impact while very burdensome to include.

2.132: In the last sentence, after the words "*the key is to compare like with like*", the words "**if possible**" should be added. It is not always possible to have all relevant information on comparables to ensure complete comparison of "like with like".

2.139: Reference to "*time*" should be removed as such information is rarely kept by enterprises.

2.152: First sentence "*either in conjunction with a traditional transaction method or on its own*". The enterprise chooses an appropriate method and the tax administration cannot impose the use of a sanity check in the sense of § 2.10. The conjunction of methods can only result from of the enterprise's choice to combine the methods.

Chapter III

Comparability Analysis

3.1: We particularly support the second sentence: "*search for comparables is only part of the comparability analysis*". Indeed, it is important to stress in the Guidelines that there are cases where data are not available or not relevant.

3.2: "*As part of the process of selecting the most appropriate transfer pricing method (see paragraph 2.1) and applying it* »; this first sentence should be suppressed because it gives the impression that comparability analysis is determinant for the choice of the transfer pricing method. It is therefore misleading.

"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". This sentence is unclear: either comparables are reasonably reliable and it is assumed that enterprise will not make further investigations to see whether there might exist more reliable ones, either the Guidelines require that the comparables used are the most reliable ones and the second sentence mentioning the limits is then in contradiction with it.

3.3: We do not support the content of this paragraph for several reasons. As we understand it, the burden of proof would be shifted from tax administrations to tax payer which is not acceptable. Moreover, it introduces the unacceptable possibility for the tax administrations to produce secret comparables: "more reliable comparables data may ultimately be found and used which is strongly fulminated by the Guidelines themselves (see §3.35). Finally, this paragraph introduces the possibility of using "ex post" comparables, which is also not acceptable.

3.10: In the third sentence "*because they create a demand for other products of the same taxpayer*", it would be welcome to add "**and/or services**" after the word "*products*". It should not be limited to products.

3.15: The last sentence implies that intentional set-offs must be in line with the arm's length principle at the time of the filling of the tax return, which means before the deposit of the tax form. This requirement seems excessive.

3.20: In the last sentence, the words "*on the comparability factors and in particular* » should be suppressed. Qualitative information should be provided with respect to functional analysis; there is no reason why standard of information provided should be higher in this situation.

3.35: First of all, the "obvious transparency reasons" that are mentioned in § 3.33, should also be included in the § 3.35. Indeed, it is of utmost importance that the transparency that is required from tax payers should be mirrored by tax administrations. Second of all, it should be stressed in this paragraph, that comparables coming from other taxpayers examinations can not in any way be opposed to a taxpayer, unless the latter has complete access to these data. Therefore, the fact that "the limits of its domestic confidentiality requirements" can be opposed to the taxpayer for justifying lack of transparency is not acceptable.

3.37: In the first sentence, the words "*not always be perfect*" should be replaced by "*unlikely be perfect*". It is well known that information on comparables is limited to what is available and that such information is generally "incomplete".

3.38: The recognition of the use of the transactional profit split method in absence of comparable is welcome. The stress on the importance of the functional analysis, even if the comparable are not perfect, to justify the selected method is also welcome.

3.55: This paragraph should be suppressed: once a comparable has been considered as having a good degree of comparability, it should not be eliminated.

3.56: This paragraph is unclear: it is not possible to give an undue position to the statistics because they would then jeopardize the analysis based on the five factors. In no way is it possible to place statistics before an analysis.

3.57: This paragraph should be suppressed. The use of more than one method is not welcome (see our general comments).

3.58: In the first sentence the words "*the application of one or more methods*" is misleading. There is only one method that is applied by taxpayers. The wording implies that it is frequent that at least two methods are used by companies, which is not the case.

3.59: We do not support the second sentence of this paragraph. As we understand it, the burden of proof would be shifted from tax administrations to tax payer which is not acceptable. The second sentence should then be suppressed.

3.60: The mechanism proposed by this paragraph introduces a threshold effect which is not acceptable: if the actual price is in the neighbourhood of the border of the range but within the range will be accepted while if the actual price is in the neighbourhood of the border of the range but without of the range it will be adjusted to a value far from the border.

3.62: It should be noted that if extreme figures appear in the range it must be considered as reliable as they are arm's length. In no case should the result be modified as long as the range is arm's length.

3.70: The second sentence raises two difficulties. First of all, a discrepancy between the approaches on documentation by different countries should not lead to different outcomes, and second of all, no different approach on analysis should occur.

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