CONTRIBUTION RECEIVED FROM MR. NICHOLAS DEE

LIST OF ISSUES FOR CONSIDERATION

General Remarks: As with all transfer pricing issues it is important to find ways of resolving the inevitable enquiries and disputes, as it is so easy for fiscs and taxpayers to find areas of disagreement. Therefore, my responses are all geared towards finding ways forward together, not conceptual models or theoretical approaches.

More imagination needs to be used by taxpayers in setting and justifying prices, by reference to third parties and the real world – and accepted and tested by fiscs as good faith efforts to set arm's length prices. More use can be made of regulatory factors in appropriate industries where the government may control or set parameters for pricing, and data may be available though prepared for a different purpose. And there could usefully be cross sector comparison where the dynamics of the profit making process are similar in different industries.

As it is now generally accepted that arm's length prices fall within a range, it is also axiomatic that a search for a possibly spurious exact comparable is not required; it may be sufficient to show that the price used is roughly right, certainly to check if further investigation of the pricing is warranted. And given the complexity of many industries and the volume of transactions, use of the 80/20 rule - 20% of the transactions accounting for 80% of the value in this instance – may be instructive.

Issue: COMP 1 – Requirement to perform an analysis of* transactions *vs. an analysis of third party information gathered at company level

I see no objection in principle to the use of company level data. Para 1.42 should be expanded accordingly. A different way of approaching this point is to assess if the structure of the pricing arrangements is comparable to third party arrangements in that industry, not to encourage recharacterisation, but to signpost if the pricing is reasonable. For instance in the pharmaceutical industry major products or blockbusters are typically not disposed of outright or extensive exclusive licences granted, but there are many sorts of co-marketing, co-promotion or limited licensing arrangements with third parties – often otherwise competitors. The structure, length and terms of such deals while varied do show what actually happens in real third party scenarios and provide probative illustrations of returns to each party. This also applies to COMP 2 below.

Issue: COMP 2 – Need to rely on transactions that took place between independent enterprises

I believe Para 1.70 should be expanded to cover the use of controlled transactions.

Issue: COMP 3 – Need to obtain third party information relevant to the review of the five comparability factors

Certain factors – such as Economic Circumstances and Business Strategies, in the broader sense, **-** may be easier to find data about, at a more macro level. The other three factors may be more difficult as the information is at a more micro level, and unlikely to be in the public domain.

If not available it may be possible to find a proxy for non-public data, but this is inherently unreliable as it is not, by definition, capable of verification. However again it may provide sufficient evidence to prove or disprove the arm's length nature of a pricing structure or methodology.
Again examples from other industries may assist as suitable proxies. And obviously internal comparables would be the best evidence in these situations.

Issue: COMP 4 – Need to ensure objectivity of the list of external comparables

This point is not clear to me in the Description. Naturally too drastic a comparability standard should not be insisted upon (again the 80/20 rule may be relevant in these circumstances).

If the cherry picking point means that parties should be denied the use of spurious or haphazard comparables, the answer is yes; they should be excluded. This is because they would not be sufficiently probative in defending or enquiring into the arm's length nature of the pricing.

Issue: COMP 5 – Determination of the years to be covered and use of multiple year data

In an ideal world audit cycles would be aligned with clearly defined business cycles, and this would facilitate assessment of the pricing. In the real world business cycles are not clearly defined, but merge into one another, and other events supervene. Nevertheless it is instructive to examine pricing over a rational time frame that allows for new products and economic circumstances, to name but two important factors. It is also sensible where the dynamics of the industry permit to look at product line pricing; though this may only be possible at a gross margin level as product line profitability on a net basis may not be available in the commercial data, and in itself can lead to more fruitless disagreement.

Issue: COMP 6 – Choice of relevant sources of information, including but not limited to commercial database

Both taxpayers and fiscs have perforce to utilise commercial databases, as they may be the only third party data available. Certainly for checking the arm's length range of pricing they are extremely valuable, both in setting prices and examining them. But they cannot and should not be used as the main determinant in setting prices as each business should embody its own way of doing business and maximise its profit making potential. Likewise they may give a fisc reason to challenge pricing, but do not provide a real alternative as to what a business should earn.
Recognising these constraints, it is also possible to use cross sector or even cross-country databases where the economic fundamentals or the nature of the businesses are sufficiently congruent. Equally it should always be recognised that in some countries or situations the commercially available databases just do not have statistically valid information.

Issue: COMP 7 – Definition of comparability adjustments where they are appropriate

Further work is definitely required in this area, and the changes and convergence of Accounting Standards in developed countries, such as the use of IAS from 2005, will have a major impact. This is because the results of most MNCs will be reported on a consistent basis.

More generally this seems to me an ideal project for BIAC and OECD to work together on to develop protocols that assist in providing guidance in this area. There will always be a need for flexibility here, but clarification of what is or is not a normal approach would help.

Issue: COMP 8 – Interpretation and use of data collected

If one is going to use statistical methodology one should also use it properly – recognising the limitations of this approach to setting prices in particular. But statistical methods do have a place and some OECD guidance would be useful. The inter-quartile approach used in the USA is acceptable. Loss making companies form part of the data set and should be used, unless their validity is negated by other statistical criteria. As usual it is worth recalling that companies do not set out to make losses but they are a fact of commercial life! Not all new products make money, but in many industries they are essential.

Really the second part of the Description goes back to the issue of whether the data is statistically robust and reliable.

Issue: COMP 9 – Specific comparability issues when applying transactional profit methods

In general I am happier with the use of TNMM than Profit Split. There is more information available about margins (from Accounts and commercial databases for instance). It is inherently more difficult to use Profit Split to set prices and the data is typically not in the public domain.

A real concern for taxpayers is that Profit Split provides fiscs with opportunities to examine information they would not otherwise be entitled to, and go for an arbitrary apportionment under the guise of getting their fair share – in itself a concept unknown in setting or examining arm's length prices in the Guidelines.

Again this would be a fruitful area for more research and discussion to take place between BIAC and OECD to allay my fears and suspicions.