

TAXREP 13/09

Transfer Pricing Aspects of Business Restructuring

Memorandum submitted in February 2009 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to the discussion draft document published in September 2008 by OECD

Contents	Paragraph
Introduction	1 - 2
General Comments	3 – 5
Issue Note 4	6 – 12
Issue Note 1	13 – 15
Issue Note 2	16 – 18
Issue Note 3	19

Annex A - Who we are

Annex B - The Tax Faculty's Ten Tenets for a Better Tax System

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INTRODUCTION

1. We welcome the opportunity to comment on the discussion draft published by OECD on 19 September 2008 at <http://www.oecd.org/dataoecd/59/40/41346644.pdf>
2. Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Annex A. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex B.

GENERAL COMMENTS

3. We recognise that this is a very important topic for many multi-national businesses and the OECD discussion draft is a useful contribution to help to create an understanding of the international tax issues and transfer pricing concepts as they should apply to such restructurings.
4. We believe that Issue Note 4 raises the most important points and for that reason we consider that it should be the first Issue Note when the final version of the paper is published.
5. As a consequence of its importance we have set out our comments on Issue Note 4 at the beginning of this paper.

ISSUE NOTE 4

6. We are concerned that the current proposals, if adopted, would undermine the basic proposition of the arm's length rule, that is to say, the transaction actually undertaken (the controlled transaction) must be compared with a comparable transaction undertaken by arm's length parties (the uncontrolled transaction).
7. If tax administrations are free to first reinvent the controlled transaction, the essential nature of the arm's length principle is subverted. The threshold for doing so is correctly and accurately stated in the existing guidelines, i.e. where proper application of the arm's length standard is impeded. One way to view this formulation is as a properly stated and focussed anti-abuse rule i.e. where the normal Transfer Pricing rules cannot properly be applied. The proposed watering down of this principle not only subverts the arm's length principle but undermines certainty and threatens the rule of law as it heightens the risk of taxation by administrative discretion and arbitrary application. It also increases the risks of double taxation requiring recourse to the Mutual Agreement Procedure. Such risks exist anyway as honest application of the guidelines can lead to different results
8. The document also makes no suggestion that the watering down of the standard should be restricted to "business restructuring" within the scope of the paper.
9. The new standard of "commercially rational behaviour" is not the same as the arm's length standard which seeks comparison with what unrelated parties do. Generally this is demonstrated by empirical evidence. This new approach

appears to attempt to give tax administrations an opportunity to hypothesise what they think the behaviour ought to be.

10. The Transfer Pricing guidelines require a transaction to “impede” for re-characterisation, not simply “restrict” as suggested by paragraph 201. We do not believe that the general formulation in paragraph 201 is a fair reflection of what the current Transfer Pricing guidelines actually state.
11. We did find the three examples (D1, D2 and D3) at the end of this section useful and would like to suggest that further examples are included in order to give a clearer picture of the features that would satisfy the test in paragraph 1.37 of the Transfer Pricing guidelines, namely that:

‘while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price.’

12. We believe that such additional examples would act to give greater clarity to the views of the OECD member countries.

ISSUE NOTE NO 1: SPECIAL CONSIDERATIONS FOR RISK

13. We believe it would be better to consider all issues about potential re-categorisation in the same Issue Note, currently No 4.
14. It would be helpful to have some extended analysis of the term ‘commercially rationale’ as we can well imagine that there may be differences of opinion between revenue authorities and taxpayers as to the ambit of such a phrase.
15. The analysis above is relevant to paragraph 58 which suggests that one should consider ‘other options realistically available’ rather than comparing the transaction that has actually been entered in to with a comparable transaction undertaken by arm’s length parties.

ISSUE NOTE NO 2:

16. The issue of exit taxation is of particular concern within the European Union where the European Commission issued a Communication in December 2006 COM(2006) 825 final in the light of various cases in the European Court of Justice and ECOFIN adopted a Resolution on co-ordinating exit taxation at its meeting on 2 December 2008.
17. While only a proportion of OECD countries are also members of the European Union it is nevertheless important that there is consensus within OECD on the topic of exit taxation and that consensus will need to take into account what is permissible for the EU Member Countries. Divergent views are expressed at paragraphs 207 re how to view commercially rational behaviour and paragraph 216 re sale of ‘crown jewels’.

18. It would be helpful to have illustrations as to how individual countries deal with compensation, e.g. certain countries, Spain and Germany, have a standard approach.

ISSUE NOTE NO 3: REMUNERATION FOR POST-RESTRUCTURING CONTROLLED TRANSACTIONS

19. We are not clear why in paragraph 180 the opening statement indicates that the restructuring described in the previous paragraphs, 177 to 179 is 'a peculiar [situation]'.

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ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 132,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.
4. To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at taxfac@icaew.com or write to us at Chartered Accountants' Hall, PO Box 433, Moorgate Place, London EC2P 2BJ.

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see <http://www.icaew.co.uk/index.cfm?route=128518>.