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Mr. Jeffrey Owens
OECD Centre For Tax Policy and Administration
OECD
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Re: Comments on Proposed Revisions of Chapters I-III of the OECD Transfer Pricing Guidelines

Dear Mr. Jeffrey Owens:

Respectfully, and pursuant to your request and that of the OECD, please find attached hereto comments below concerning the above aforementioned Proposed Revisions of Chapters I-III of the OECD Transfer Pricing Guidelines. We appreciate the opportunity to take part in the OECD's Process Regarding Transfer Pricing and look forward to working with you again in Paris.

Comments On Proposed Revisions of OECD Transfer Pricing Guidelines

1. Status of Transactional Profit Methodology as Methodology of Last Resort

One could argue that the U.S. Transfer Pricing Regulations do or don't prescribe a hierarchy of Transfer Pricing Methodologies. What is required of the taxpayer and its advisors and consultants is that they use the "Best Method". The Best Method is defined as the Transfer Pricing Methodology that provides the most reliable results under the circumstances. Examples from the U.S. Transfer Pricing Regulations state in some cases that a Transactional Approach is preferable to a Profits Based Approach in determining Arm's Length Transfer Prices. The example(s) imply that the transactional approaches when present are in fact most reliable under a given set of circumstances. In effect, the current and predecessor U.S. Transfer Pricing Regulations from 1968 and 1993/1994 and most current revisions may not be that different that the current OECD Guidelines in actual application. As the OECD has made revisions to its Transfer Pricing Guidelines, the U.S. Regulations and the OECD Guidelines are seeing a convergence of best practices that produce the most reliable result under the circumstances. This author applauds the OECD's efforts in bridging a gap between theory and practicality. Issue Note 1 focused on the question of whether to maintain the "Transfer Pricing Methodology of Last Resort" or adopt an easing of standards, more practicable, and necessary profits based approach where transactional based approaches are not evident, nor produce the most reliable results under the circumstances. (See Paragraphs 2.49, 3.49, et. al of the Guidelines). The tentative conclusion to Working Party No. 6 to remove the "exceptionality standard" or method of "last resort" moves the determination of arm's length transfer pricing in the right direction utilizing whatever Transfer Pricing Methodology that produces the most reliable results under the circumstances.

2. Use of More Than One Methodology

The OECD and Working Party No. 6 have made tremendous progress in giving thoughtful consideration to the utilization of the adoption of use of multiple transfer pricing methodologies. In twenty years of governmental and practitioner experience a secondary, supplementary, or corroborative methodology has been used, especially in controversy or tax litigation contexts, to provide verification of the primary methodology. Many of these experiences have been successful in OECD based countries and in an audit context where the primary methodology was an inexact transactional based approach where exact transactional comparables were not available or did not provide the most reliable results due to functional, risk, or asset utilization differences or alternatively differences in contractual terms between related parties and unrelated parties.

3. Data Availability

In many cases, internal or external transactional data is just not available or reliable necessitating the need for a profits bases approach such as the TNMM. This author's experience has shown OECD Governmental Tax Authorities very aware of this problem. As is required in the U.S. Treasury Regulations Section 1.482, the OECD and Working Party No. 6 may want to consider an accentuated "U.S. Best Method Analysis" or some variant therefore. This would involve a requirement of the taxpayer where a transactional based approach in not utilized to explain why each OECD enumerated and sanctioned methodology was not acceptable and why the analysis had to rely on a profits based approach to reach the most reliable result. Additionally, practitioners have even observed that some lesser developed country tax authorities (India and Vietnam) and other countries where public company data is not readily available are relying heavily, if necessary, on private company data to reach the most reliable result in an arm's length determination as sometimes transactional based approaches just do not exist.

4. Transactional Profit Split and Unique Contributions

Transactional based approaches may not be the most reliable when a lack of third party comparable data is apparent. Some practitioners would argue that rarely is an exact comparable ever found whether be it a transactional based comparable or a profits based comparable plucked from a database. Issues of embedded intangible property in general that may exist in reviewing public filings and or comparable company information may make any TNMM profits approach impracticable. Under these circumstances, the best "secondary" or "corroborative" methodology for establishing arm’s length pricing and producing the most reliable result would be a transactional based analysis.

5. Application of the Transactional Net Margin Methodology (“TNMM”)

The OECD and Working Party No. 6 has made improvement in the area of testing on an aggregated basis when utilizing a profits based approach without compromising the rigorous analysis that still should be anticipated by the taxpayer and their advisors and consultants. The deferment to “Other Non-Prescribed Transfer Methodologies” and flexibility contemplated by the OECD and Working Party No.6 will allow taxpayers to best demonstrate and meet the Arm’s Length Standard so long as they simultaneously pursue an accentuated U.S. based “Best Method” variant analysis whereby they are able to clearly articulated the reasons for not utilizing a transactional based analysis or other OECD sanctioned Transfer Pricing Methodologies.

6. Application of the Transactional Net Margin Method (“TNMM”)

The Discussions Draft succinctly states and provides clear guidance of the parameters of use of the TNMM including costs and revenues, non-operating items, financial terms, depreciation and amortization, start-up and termination costs, pension costs, and stock options. This author agrees with these parameters that should provide clear guidance to the taxpayers and their advisors and consultants in the implementation of said OECD Guidelines. This author would also recommend for future consideration to the OECD and Working Party No. 6 that financial ratios be utilized to provide more accuracy and certainty when utilizing a profits based approach and a ROCE Profit Level Indicator (”PLI”). The author recommends the use of financial ratios such as receivables to net sales, inventories to net sales, net property, plant, and equipment to net sales, et. al.

7. Application of a Transactional Profit Split Method

This author concurs with the OECD and Working Party No.6 in that assumptions on matters of accounting standards and selection of profit measurement tools be made ex-ante and contractually memorialized in a written intercompany operating agreement. This author also suggests examples for purpose of clarification and administrative and litigation relevance to the issue of sanctioned profit splits and profit losses scenarios removing any potential uncertainty from the transfer pricing equation.

8. Application of a Transactional Profit Split: Reliability of a Residual Analysis and a Contributional Analysis

This author agrees with the OECD and Working Party No. 6 in that a full contribution analysis should be made on the combined profits and with respect to those cases in which a residual analysis is more reliable. First an attempt should be made to utilize transactional based approaches to determine remuneration when available data exists and is considered the most reliable under the circumstances. Only after exhausting all available transactional or most reliable Transfer Pricing Methodologies should the excess profit or residual profit then be appropriately split between the related parties on a risk, function, and asset utilization basis. The full contribution analysis is more reliable in the event that no other reliable methodologies evidence themselves.

9. Splitting the Profits (Combined and Residual)

The general requirements governing the choice of the allocation keys that are used to split the combined profits are (1) Consistency with comparability (including Functional Analysis) of the controlled transactions under review; (2) Consistent with those which would have been agreed upon between independent parties in comparables circumstances; (3) Independent of transfer pricing formulation…based on objective data rather than data relating to controlled transactions; (4) Capable of being measured in a reasonably reliable manner; and (5) Consistent with the type of profit split approach (contribution or residual analysis). This author would recommend that OECD and Working Party No.6 give additional thought to providing additional guidance or examples for illustrative purposes on the "essence" of the "arm's length principal" as it relates to intangible property and how licensing agreements are negotiated on an arm's length basis between two unrelated parties independently and also through the memorilization process via licensing agreements or alternatively cross-licensing agreements in specialized and nuanced industries including the pharmaceutical and software industries, et. al.

10. Other Methodologies

This author maintains and observes that as long as all other potential and more reliable Transfer Pricing Methodologies are ruled out and memorialized in the Transfer Pricing Documentation as is required pursuant to the United State Treasury Regulations Section 1.482 that "Other Methodologies" are acceptable, and desirable, as determined by the OECD and Working Party No.6 if no other reliable Transfer Pricing Methodologies exist. In fact, the U.S. Transfer Pricing Regulations enumerate options for "Other Methodologies" in the event that one of the prescribed methodologies is not contemplated to produce the most reliable result.