



TAXREP 1/10

PROPOSED REVISION OF CHAPTERS I – III OF THE OECD TRANSFER PRICING GUIDELINES

Memorandum submitted in January 2010 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a consultation document published on 9 September 2009 by Organisation for Economic Co-operation and Development (OECD)

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ICAEW Tax Faculty, Chartered Accountants' Hall,
PO Box 433, Moorgate Place, London EC2P 2BJ, UK
www.icaew.com/taxfac

T +44 (0)20 7920 8646
F +44 (0)20 7920 8780
E taxfac@icaew.com

PROPOSED REVISION OF CHAPTERS I – III OF THE OECD TRANSFER PRICING GUIDELINES

INTRODUCTION

1. We welcome the opportunity to comment on the proposed revision of Chapters I-III of the OECD Transfer Pricing Guidelines published on 9 September 2009 at <http://www.oecd.org/dataoecd/1/57/43655703.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 POINTS

3. We believe that the revisions help to bring the OECD Transfer Pricing Guidelines into step with current transfer pricing practices.
4. There is no consideration in the Guidelines of the impact of the recession and we believe that there should be some recognition that a recession can have an impact on commercial behaviour.
5. There will need to be further revisions to the Guidelines to reflect the impact of the project on Business Restructuring and it would be helpful for there to be a note that such revisions will be made once the issues raised by the Business Restructuring project are finalised.

SPECIFIC POINTS

Chapter I – The Arm's Length Principle

section C – A non-arm's length approach: global formulary apportionment

6. We are a little concerned that the treatment of global formulary apportionment in paragraphs 1.16 to 1.32 is rather too dismissive of the serious possibility of such apportionment being adopted for certain countries within the European Union when the Common Consolidated Corporate Tax Base (CCCTB) project is revived under the new Commission. OECD is perfectly at liberty to reiterate, as it does in paragraph 1.32, its support for the arm's length principle but there should be a more even handed treatment of the alternative.
7. In particular the discussion in paragraph 1.23 is on the basis that under formulary apportionment individual countries would be free to pick and choose the allocation keys to suit their own economies. Whereas the CCCTB proposals, unlike US state tax formulary apportionment, is expressly in terms of the same allocation keys being adopted by participating EU countries. We believe this potential (EU) 'scenario' ought to be recognised in the OECD guidelines. In addition the CCCTB proposal is that the sales allocation key should be applied by destination which would make manipulation more difficult

which is one of the arguments in the Guidelines against the formulary apportionment proposal.

8. Again in the CCCTB proposal it is currently intended that Intellectual Property would be excluded and this could be mentioned in paragraph 1.28.
9. As an overall point in relation to the arm's length principle it is also worth noting the recent UK High Court decision (17 November 2009) in the Test Claimants in the Thin Cap GLO, see <http://www.bailii.org/ew/cases/EWHC/Ch/2009/2908.html> One of the points decided in that case was that in the absence of a separate commercial let out the pre Finance Act 2004 UK Thin Cap legislation is not consistent with the EC treaty – now formally known as the Treaty on the Functioning of the European Union (TFEU). In other words the consequences arising from the UK High Court decision is that the arm's length standard on its own is not necessarily compliant with EU law.

Section D – Guidance for applying the arm's length principle

Comparability analysis

10. We believe it may be overly simplistic to state in paragraph 1.34 that one enterprise 'is unlikely to accept a price offered for its product by an independent enterprise if it knows that other potential customers are willing to pay more under similar circumstances.' Surely it is only in identifying the factors to be evaluated in determining whether or not 'similar circumstances' exist that a seller could simply take the highest price. Such factors might include credit and exchange risk, money laundering status of the potential customer and a number of other potentially relevant circumstances. At the end of the day the arm's length principle can be problematic to apply in practice and we believe this needs more explicit recognition in the Guidelines.

Recognition of actual transactions undertaken

11. We believe that paragraph 1.64, which was previously paragraph 1.37, should also reflect the language in paragraph 208 of the Consultation Document on Transfer Pricing Aspects of Business Restructuring. Namely 'Tax administrations should not ordinarily interfere with the business decisions of a taxpayer as to how to structure its business arrangements. A determination that a controlled transaction is not commercially rational must therefore be made with great caution, and only in exceptional circumstances lead to the non-recognition of the related party arrangements'.

Chapter II Transfer pricing methods

12. We welcome the elevation of the net profit methods to an equal par with the existing transaction methods and the removal of the stigma that hitherto attached to the transactional net margin method (TNMM). However we believe that the current draft Guidelines put too great an onus on examining a range of different methods whereas the requirement should be to select and use a method that is practical and which gives an appropriate result without an exhaustive search for, or consideration of, all possible methods. So, for

instance, in paragraph 2.1 the reference should be to finding an ‘appropriate’ method rather than, as currently drafted, the ‘most appropriate’ method.

Chapter III Comparability analysis

Comparable uncontrolled transactions

13. We believe that the Guidelines should make it clear that taxpayers are entitled to rely on information that is reasonably available to them at the time that they evaluate the arm’s length nature of their transfer prices. We are concerned that paragraph 3.35 suggests that tax administrations can use ‘secret’ information in a subsequent transfer pricing enquiry as long as they disclose such ‘secret’ information to the taxpayer during the enquiry. We do not believe that this is reasonable.

Selecting or rejecting potential comparables

14. In the final bullet point in paragraph 3.42 we believe it would be better to refer to the third parties being in ‘particular special’ rather than ‘peculiar’ situations. Start ups and bankruptcies are not the norm but they are non standard rather than peculiar. If amended the full bullet point would read as follows:

‘Other criteria to exclude third parties that are in particular special situations such as start-up companies, bankrupted companies, etc. when such special situations are obviously not appropriate comparisons.’

Timing issues in comparability

15. We believe that in paragraph 3.70 it would be helpful to recognise explicitly the possibility of Arbitration, also envisaged under Article 25, if the Mutual Agreement Procedure proves unsuccessful.

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E ian.young@icaew.com

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
2. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.
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 www.icaew.co.uk/index.cfm?route=128518.

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