MAISTO E ASSOCIATI

ASSOCIAZIONE PROFESSIONALE

Milan, 7 January 2010

Mr Jeffrey Owens, Esq.
OECD Centre for Tax Policy and Administration
2, rue André Pascal
75775 Paris Cedex 16
FRANCE

Dear Mr Owens,

Re: Proposed Revision of Chapters I–III of the Transfer Pricing Guidelines

Maisto e Associati is pleased to provide its comments in response to the OECD Centre for Tax Policy and Administration's public invitation to comment on the "Proposed Revision of Chapters I–III of the Transfer Pricing Guidelines", released on 9 September 2009 (the "Proposed Revision").

Firstly, we commend the OECD for its efforts to update the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations adopted in 1995 (the "1995 Guidelines") as the revisions proposed improve clarity on several practical issues that arise in dealings between associated enterprises.

The abolition of the last resort status of transactional profit methods is a welcome step towards aligning the 1995 Guidelines with the business practices adopted by multinational enterprises and reflects the increasing experience of many countries' tax authorities and taxpayers with transactional profit methods, and thus supports a wider acceptance of these methods.

This being said, we believe that some paragraphs forming part of the Proposed Revision raise concerns or ambiguities and for this reason we call for clarifications to improve the consistency between the

PIAZZA F. MEDA, 5
20121 MILANO
TEL. +39.02.776931
FAX +39.02.77693300
email milano@maisto.it

PIAZZA D'ARACOELI, 1
00186 ROMA
TEL +39.06.45441410
FAX +39.06.45441411
email roma@maisto.it

2, THROGMORTON AVENUE
LONDON EC2N 2DG
TEL. +44.(0)20.73740299
FAX +44.(0)20.73740129
email london@maisto.it

various sections of the 1995 Guidelines. Our comments point at three different main issues:

1. The removal of the last resort status of transactional profit methods raises uncertainties as to their relationship vis-à-vis traditional transaction methods. This requires clarification.

2. The new sections added to the 1995 Guidelines require a better coordination with the sections dealing with the application of traditional transaction methods that have not been updated and which present a lower level of detail. This raises doubts as to whether, and under which circumstances, the principles laid down for the application of transactional profit methods may be valid also for the application of traditional transaction methods.

3. As many additions introduced by the Proposed Revision are of an innovative nature, we believe it would be necessary to avoid their retrospective application against taxpayers who may have relied on the 1995 Guidelines for past taxable periods. We have indeed experienced retrospective application of the (more detailed) principles laid down in the 1995 Guidelines to taxable periods for which the taxpayer relied on the 1979 OECD Report "Transfer Pricing and Multinational Enterprises".

The points below set out specific comments referring to one or more paragraphs of the Proposed Revision. We hope they may be useful in further development of the 1995 Guidelines.

Chapter 1 – Section B – Statement of the arm's length principle
Paragraph 1.7
The paragraph refers to the possibility of a "re-writing of the accounts" under Article 9 of the OECD Model Tax Convention.

This wording is not appropriate for Member countries where transfer pricing adjustments are relevant for income tax but not for accounting purposes and may thus be misleading. It would therefore be desirable to replace the phrase "re-writing of the accounts" with "making adjustments to the taxable income of".

Chapter 1 – Section D – Guidance for applying the arm's length principle
Paragraph 1.39
Amongst the features of intangible properties to be taken into account in determining the comparability of controlled and uncontrolled transactions, Paragraph 1.39 mentions the "anticipated benefits from the use of the properties".

In a transaction between independent enterprises in the free market, the anticipated benefits from the use of an intangible property may widely differ for the two parties of the transaction due, for example, to information asymmetries, different business perspectives or opportunities in the utilization of the property, or specific factors pertaining to one of the parties.

Given the high subjectivity of the evaluation of the anticipated benefits of an intangible (particularly when such evaluation should be executed on the comparables), we believe it would be necessary to better clarify such reference or, at least, specify the party in relation to which anticipated benefits should be evaluated.

Paragraphs 1.77 and 1.78

These paragraphs touch upon the interaction between customs and income tax and refer to the possibility that customs valuations are used by tax administrations in evaluating the arm's length character of a controlled transaction.

We believe it would be worthwhile to include similar considerations also in respect of VAT valuations in cases where the tax administrations take into account the fair market value for applying VAT (which is an increasingly frequent case within the European Union and it is allowed when the parties of the transactions are related and engaged in activities where the right to deduct input VAT may be limited). Thus, additional paragraphs to this effect would be welcomed.

Chapter II – Part I – Section A – Selection of the most appropriate transfer pricing method

General comment

The Proposed Revision replaces the hierarchy of methods laid down by the 1995 Guidelines with a more flexible standard whereby the selected transfer pricing method should be the "most appropriate" method to the circumstances of the case.

Nevertheless, we believe that further guidance should be provided for the identification of the "most appropriate method".

More specifically, Paragraph 2.7 states that it is not necessary "that all the transfer pricing methods should be analysed *in depth or tested* in each case in arriving at the selection of the most appropriate method". This statement seems to be in contrast with the subsequent Paragraph 2.10 stating that "these Guidelines do not require either the tax examiner or the taxpayer to perform analysis under more than one method", thus seemingly excluding the obligation to perform any kind of analysis on more than one method. We believe it would be necessary to specify in more detail the scope and degree of analysis and testing that the taxpayer is required to make on the various transfer pricing methods in order to select the most appropriate one, i.e. the degree of analysis that is required, for example, to exclude the application of a particular transfer pricing method.

The issue is particularly relevant in respect of traditional transaction methods. Indeed, Paragraph 2.2 still provides for a preference of the traditional transaction methods over the transactional profit methods and, amongst the traditional transaction methods, of the comparable uncontrolled price method (CUP) over the other methods whenever there is an "equally reliable" result, raising doubts as to whether the taxpayer has the duty or the possibility to test the possible application of transactional profit methods in cases where a traditional transaction method may be applied in a reliable manner. It would also be appropriate to specify whether the taxpayer could exclude the application of traditional transaction methods because they are not "equally reliable" without conducting an attempt of application of the same traditional transaction methods or at least to what degree should such an attempt be conducted.

We also believe it would be appropriate to add a statement clarifying that the adoption of a certain transfer pricing method by the taxpayer shall not be relevant for income tax matters other than the determination of the arm's length price.

For example, it might be appropriate to clarify that the fact that a certain transfer pricing method is adopted to establish the conditions in a transaction between associated enterprises (e.g. resale price method or cost-plus), shall not on itself mean that an associated company is to be regarded as a permanent establishment of the other, due to the limitation of entrepreneurial risk deriving from the existence of a fixed remuneration.

Paragraph 2.8

The paragraph puts an obligation on the taxpayer "to maintain and be prepared to provide documentation regarding how its transfer prices were established". We believe that this paragraph, in providing for an obligation for the taxpayer to maintain transfer pricing documentation, is not fully appropriate, as this could be contrary to domestic rules governing the burden of proof.

In our view, it would be necessary to specify that such a requirement is in any event subject to the application of the rules governing the burden of proof in the relevant jurisdiction, in order to make it compliant with Paragraph 5.2 that is clear in saying that the 1995

Guidelines are not intended to impose a greater burden on taxpayers than is required by domestic rules.

Chapter II – Part III – Transactional profit methods
General comment

We believe that it would be useful to clarify in which cases the 1995 Guidelines provided for in relation to transactional profit methods (particularly the transactional net margin method) may be referred to also for the application of the traditional transaction methods, as applicable. For example:

– Paragraph 2.126 provides for some guidelines regarding to what extent start-up costs and termination costs should be included in the determination of the margin indicator. It would be appropriate to specify whether the same rule may apply in respect of traditional transaction methods.

– Paragraphs 2.134 and 2.135 mention the possibility to treat a portion of costs as pass-through costs to which no profit element is attributed (i.e. costs that could be excluded from the denominator of the net profit margin indicator). Considering the relevance of this statement, it would be appropriate to specify whether it applies also for the application of the cost-plus method, by specifying whether and to what extent it is acceptable to characterize costs as "pass-through" in an arm's length analysis.

– Paragraph 2.136 refers to the issue of whether actual, standard or budgeted costs should be used in the application of the transactional net margin method and concludes that pricing adjustments based on actual costs could be taken into account only if they reflect arrangements that would be taken at arm's length, between independent parties. Paragraph 2.45 of the 1995 Guidelines (renumbered Paragraph 2.56 under the Proposed Revision) for the same issue in relation to the cost-plus method seems instead to provide a different indication as it states that "*the associated enterprises may agree in advance which costs would be acceptable as a basis for the cost-plus method*". Such latter statement seems indeed to give the taxpayer the possibility to decide whether relying on actual or standard costs while such possibility is not envisaged in Paragraph 2.136.

Chapter II – Part III – Section C - Transactional net margin method
Paragraph 2.105

The paragraph states that, notwithstanding the application of a "one-side method", the comparability analysis must always be performed in order to appropriately characterize the transaction between the parties and choose the most appropriate transfer pricing method. This analysis generally necessitates some qualitative information to be collected on both the tested and the non-tested party.

A requirement of qualitative information on the functional analysis of the non-tested party is also stated in Paragraph 3.20. We believe that this requirement to acquire information on the non-tested party undermines one of the most significant features of “one-side methods”, which is that of not requiring the analysis to be extended to both the parties of the transaction, as stated in the first sentence of Paragraph 2.105 (“*another practical strength of the transactional net margin method is that, as with any one-side method, it is necessary to examine a financial indicator for only one of the associated enterprises (the “tested” party)*”).

It would therefore be appropriate to reconsider such requirement.

Paragraphs 2.131 – 2.132
The paragraphs provide some clarification on cases where the net profit is weighted against sales. They do not, however, address the issues of whether reference shall be made to actual or forecasted sales revenue (as is instead for the case of the transactional profit split method under Paragraph 2.81 et seq.) and whether an adjustment is required for differences between actual sales revenue recorded at the end of the year and forecasted sale revenue. More detailed guidelines would be appropriate in this respect.

Paragraph 2.138
The paragraph deals with cases where the net profit is weighted to assets and addresses the issue of how to evaluate the relevant assets (e.g. at book value or at fair market value).

In this respect, more instructions should be addressed to clarifying how to determine the assets’ value. In particular, our suggestion would be not to adopt the fair market value, since this would imply significant difficulties in determining the fair market value of the assets of the comparables, due to the lack of available information on third parties. Should a different conclusion be met, the Proposed Revision should clarify which are the self-developed intangibles that could be taken into account (i.e. trademark, goodwill, etc.).

We appreciate the opportunity to provide our comments on the Proposed Revision and thank you for your attention to this matter. We trust you will find these comments useful as you work towards producing the final revision to the 1995 Guidelines.

Please feel free to contact us with any questions or comments concerning this letter.

Respectfully,

(Maisto e Associati)