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Mr. Jeffrey Owens
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Proposed revision of Chapters I-III of the Transfer Pricing Guidelines
Discussion draft for public comment
9 September 2009 to 9 January 2010

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Dear Mr. Owens,

VNO-NCW, the Netherlands Employers Federation, representing the large majority of small, medium and large enterprises in The Netherlands is pleased to respond to the OECD request to send comments on the Discussion Draft on the Chapters I-III of the Transfer Pricing Guidelines of 9 September 2009 (hereafter referred to as "the Draft").

VNO-NCW observes that substantial work has been done and generally supports the majority of conclusions made in the Draft.

VNO-NCW is however in some parts of the Draft concerned about ambiguity, especially between principles and examples, unclarity about definitions and wording used, and an increased administrative burden on the taxpayer. The above has the inherent risk of double taxation.

The Draft in numerous places mentions balancing the reliability in documenting intercompany transactions and the administrative burden on taxpayers. In this regard, principles are provided how to deal with this balance. The guidance given to perform analyses and documentation following these principles is in many instances quite prescriptive and goes beyond providing helpful hints and tips on the principle point described. This results in ambiguity. Also, the Draft mentions terminology such as "reasonable reliable comparables" and "most appropriate method" without properly explaining what this means. This may give rise to tax authorities to request for further documentation to meet the criteria, which leads to an

unbalanced increase of the administrative burden and cost for the taxpayer. The aforementioned inherently carries the risk of double taxation.

The OECD Guidelines are globally the standard for dealing with intercompany transactions. The Guidelines are especially followed by member States, but also a significant number of non-member States follow them. VNO overall observes that the Draft leads to more complexity. To deal with this is a challenge for all affected and even more so for the developing countries. To address application of the Draft for the developing countries, VNO-NCW encourages the OECD to interact with the United Nations.

The above will be explained in more detailed in specific comments on the Draft.

OPENING REMARKS

The Draft analyses and reaffirms a number of generally supportable principles such as the status of the Arm's Length Principle ("ALP") as the international transfer pricing standard, acknowledgement of the balance between the effort to be undertaken on comparability versus materiality of the controlled transaction and leaving the last resort status of transactional profit methods with the introduction of the most appropriate method standard.

However, there are a number of concerns that VNO-NCW wants to highlight.

- **Ambiguity**
  - The Draft in numerous places describes principles on how to deal with comparability but then provides guidance that goes beyond the principle point described. VNO-NCW requests the OECD to more clearly elevate the point to be made in the Draft by describing it as a "principle" upfront in the text and indicating that the guidance given thereafter only serves as non-exhaustive examples. In this regard, VNO-NCW suggests to mark the comments in ¶3.81 *on the balance between the effort to be undertaken on comparability versus materiality of the controlled transaction* as a "principle" and move it to the beginning of Chapter III.
  - Similarly, VNO-NCW suggests following the same approach as above for the "principle" in ¶3.80 when undertaking a comparability analysis, *there is no requirement for an exhaustive search of all possible relevant sources of information*. However, in ¶3.3 it is mentioned that despite reasonable efforts made by a taxpayer in finding and selecting comparables, it cannot rule out the possibility that more reliable comparables data may ultimately be found and disclosed by a tax administration and used in determining an arm's length outcome. VNO-NCW disagrees with the latter view and strongly prefers to follow the taxpayer's selection of comparables if reasonable efforts have been made by

taxpayer, that have been substantiated with appropriate transfer pricing documentation, unless this clearly results in an outcome that does not provide a reliable estimate of the arm's length result.

- **Unclarity about definitions and wording**
  - The Draft has introduced the term "reasonably reliable comparables" without proper guidance on what this constitutes.
  - In our view, the existing Guidelines give insufficient direction to tax authorities about the relevance of the comparable uncontrolled price method for *commodity transactions* (i.e. transactions that are conducted and priced in accordance with standard industry practice and pricing conventions or follow (global) quoted prices). Much of the commentary in the Draft is directed at replicating the dynamics of market forces in situations that may be well removed from an open market situation. Such commentary, however, are of very limited relevance for commodity transactions, that are conducted and priced in accordance with standard industry practice and pricing conventions or follow (global) quoted prices. VNO-NCW request the OECD to formally include in the Draft that detailed analysis for the comparability factors other than product or services characteristics and contractual terms is not required when pricing is based on commodity transactions.
  - VNO-NCW strongly supports the comments in the Draft on avoiding or taking care to avoid the use of hindsight by tax authorities. Moreover, VNO-NCW is concerned that the use of hindsight might cause discussions between taxpayers and tax authorities and therefore proposes to use stronger wording that tax authorities should use the information available at the time the transactions were entered into. The use of hindsight should not be allowed.
- **VNO-NCW is concerned about the trend to increase the administrative burden and costs of complying with international tax rules**. This is again confirmed in the Draft and VNO-NCW especially requests for alleviating some of the administrative requirements as mentioned hereafter.
  - VNO-NCW is concerned that the concept of "most appropriate method" in practice will result in discussions between taxpayers and tax authorities on what the "most appropriate method" in a specific case is. VNO-NCW requests OECD to clarify explicitly that it is not intended to introduce a "best method" approach, leading to additional administrative burden. Further, and in line with the proposed ¶1.13 and ¶2.9, VNO-NCW is of the opinion, that if taxpayer has gone through a thorough selection process, deference to the taxpayers position should be given, unless this clearly results in an outcome that does not provide a reliable estimate of the arm's length result for the taxpayer's related party transaction. The burden of proof to determine that the selected

method is clearly not resulting in an arm's length outcome should be on the tax administrators.

- The Draft describes that other methods than the ones described in the Guidelines can only be used in case the OECD-recognised methods are regarded as non-appropriate or non-workable and an explanation is given why the other method is regarded as providing a better solution. VNO-NCW feels that this is inconsistent with the principle mentioned that a MNE group is free to apply any method as long as it satisfies the ALP and the most appropriate method selection principle.
- The Draft mentions that the use of more than one method is not required. VNO-NCW strongly agrees with this. However, the Draft further mentions that for difficult cases, where no one approach is conclusive, a flexible approach would allow evidence of various methods to be used in conjunction. This is inconsistent with the principle mentioned that the use of more than one method is not required. Therefore, OECD is requested to further clarify in ¶2.9 and ¶2.10 that any use of secondary methods, be it for difficult situations or for corroboration, is at the sole discretion of the taxpayer.
- VNO-NCW observes that, given the attention, the level of detail provided and the chosen wording in various paragraphs in the application of the transactional profit split method ("PSM"), the OECD seems to position the PSM ahead of the Transactional Net Margin Method ("TNMM") or seems to indicate that the TNMM should be corroborated with the PSM (proposed in ¶2.108). VNO-NCW requests the OECD to confirm that within the transaction profit methods there is no difference in hierarchy of the PSM and TNMM.
- The Draft seems to question current practice of benchmarking and use of commercial databases. VNO-NCW agrees that quality is more important than quantity when using databases. In a selection process of potential comparables qualitative analysis is performed by MNEs where possible to ensure comparability. However, this should not entail that a full functional risk analysis of the potential comparables is required. First of all because such information is in most cases not publically available and for that purpose, amongst others, the range concept is used. Further, as mentioned before, such requirements would also impose an unbalanced additional administrative burden on taxpayers. VNO-NCW is of the opinion that also for these purposes deference to the taxpayer's analysis should be given, unless this clearly results in an outcome that does not provide a reliable estimate of the arm's length result for the taxpayer's related party transaction.

Besides the fundamental issues mentioned above, VNO-NCW wants to provide additional comments to the three proposed Chapters.

CHAPTER I THE ARM'S LENGTH PRINCPLE

¶1.7 of the Draft uses the term re-writing of "accounts" in relation to the comparability analysis. Although reference is made to Article 9 of the OECD Model Tax Convention in which similar wording is used, VNO-NCW is of the opinion that using the word "accounts" could be misleading as different kinds of accounts exist within an MNE Group (i.e. managerial, statutory or financial accounts). Similarly, in other parts of the Draft "accounts" are used where it is unclear to what type of accounts reference is made (e.g. ¶2.79). The OECD is requested to provide further clarification what kind of accounts is meant.

The Draft states in ¶1.34 that independent enterprises will compare the transaction to the other options realistically available to them and will enter into the transaction if they see no alternative that is clearly more attractive. VNO-NCW notes that the concept of 'options realistically available' raises serious concerns. If a business would be required to evaluate and document every possible option for an intercompany transaction for each legal entity, the business processes would be severely hindered and delayed. VNO-NCW suggests eliminating the paragraph. Further reference is made to VNO-NCW comments on the OECD Draft Transfer Pricing Aspects of Business Restructurings regarding the same point.

Guidance on applicability of the comparability factors is provided in the Draft in ¶1.53. This paragraph mentions that the comparability factor regarding contractual terms may be less critical if the controlled transaction is the provision of back-office accounting services. VNO-NCW welcomes this guidance on applicability of the comparability factors and encourages the OECD to provide further guidance where comparability factors do not have a critical effect on the price or the margin and therefore do not require detailed analysis.

¶1.57 notes that in certain circumstances it may be appropriate that a MNE group can rely on a multiple country comparable analysis. VNO-NCW strongly supports this approach, which is also in line with the recommendations of the EU JTPF. VNO-NCW suggests to add even worldwide searches if proper regard is being given to the particular circumstances of the subsidiaries. With respect to the last sentence of ¶1.57 VNO-NCW is concerned that taxpayer and tax authorities will have discussions on the "systematic use" and therefore suggests a positive phrasing to make sure a systematic use of regional or even worldwide searches is permitted if proper regard is being given to the circumstances of the subsidiaries.

¶1.58 notes the need to examine business strategies for determining comparability. Where VNO-NCW generally can support this, it is questioned what the relevance is of who sets business strategies. In an MNE group it is

often common that business strategies are devised centrally. The adopted business strategy should subsequently be part of the comparability analysis and resulting transactions should be at arm's length, independent of who set the business strategy.

CHAPTER II TRANSFER PRICING METHODS

In ¶2.88 the Draft mentions a number of allocation keys that are most commonly used in practice, where other allocation keys are also sometimes encountered. This seems to indicate that the Draft only recognizes a limited number of allocation keys, as well as a certain hierarchy in the use of the allocation keys. VNO-NCW wants to emphasize that other allocation keys than mentioned are also commonly used. Therefore, VNO-NCW would like to request the OECD to remove the reference to *most common* and add the wording that the reference to specific allocation keys is for illustration purposes only, where other allocation keys may be appropriate as well depending on the facts and circumstances of the transactions.

In ¶2.92 the Draft discusses accounting classifications of costs and consistency in relation to determination of the allocation key. While VNO-NCW in principle agrees with the commentary, careful consideration should be given how to address the guidance given. In this respect, the example on different levels of costs for high labour-cost versus low labour-cost countries can be misleading. It may be very appropriate to use the type of allocation key as mentioned in the example (i.e. labour cost), where the level of investment made in relation to a controlled transaction is reflective of the benefit received. VNO-NCW suggests removing the last sentence of this paragraph.

In ¶2.97 the Draft notes that internal data may also be helpful where the allocation key is not based on statutory accounting but rather on a cost accounting system. It seems unlikely that an allocation key would be based on the statutory accounts, which tend to reflect regulatory disclosure requirements and generally do not report the information referred to. VNO-NCW requests for clarification.

For the PSM as described in chapter II, VNO-NCW wants to emphasize that this two sided method can only be used for highly integrated operations for which a one-sided method would not be appropriate and in cases where e.g. one party to the transaction does not make any significant unique contributions (e.g. contract manufacturing, distributor or contract service activities in relevant circumstances), a PSM typically would not be appropriate in view of the functional analysis of the parties involved.

VNO-NCW is concerned that in the current revised chapter II, with the introduction of the term "non-unique intangibles", an increased risk of double taxation can occur when tax administrations have a different view on what

can be considered as a unique or non-unique intangible. More and clear guidance is welcome on the definition of non-unique intangibles and when the PSM can be applied.

The Draft comments in ¶2.105 that comparability analysis must always be performed and this analysis generally necessitates that some qualitative information be collected on both the tested and non-tested party. VNO-NCW requests clarification on what level of qualitative information should be required. VNO-NCW does not agree with this view also for these purposes deference to the taxpayer's analysis should be given, unless this clearly results in an outcome that does not provide a reliable estimate of the arm's length result.

The Draft in ¶2.124 discusses when it will generally be appropriate to consider the effect of interest when determining the net profit margin. VNO-NCW requests for clarification what is meant with *financial activities* and *other situations where the capital structure may heavily influence the prices* and believes that with the above reference is made to loan financing and leasing generally undertaken by banks and treasury departments. VNO-NCW would like to request the OECD to include in the Draft that in other situations the arm's length character of the capital structure will be solely based on local thin capitalization rules, if any. If the taxpayer is within the limits of the local thin capitalization rules, the effect of interest will not be taken into account to determine the at arm's length remuneration for the TNMM.

The Draft in ¶2.126 discusses the treatment of start-up and termination costs, which topics are experienced frequently in practice and often lead to disputes between taxpayers and tax authorities. VNO-NCW wants to emphasize that the exclusive benefit relation is only one of many factors how to deal with start-up and termination costs and welcomes the OECD to provide more guidance on this point as well as guidance on when to apply a mark-up.

The Draft in ¶2.129 discusses that the denominator should be reasonably independent from controlled transactions. VNO-NCW agrees with this principle but does not agree with the conclusion that if the denominator consists of controlled transactions there is no objective starting point. If the taxpayer has undertaken a comparability analysis to substantiate the controlled transaction (e.g. head office charges) being arm's length, VNO-NCW believes that the denominator (inclusive of head office charged costs) in that case is not materially affected and can serve as the denominator to test another controlled transaction. Therefore, VNO-NCW suggests including the above commentary in the paragraph.

VNO-NCW further requests to include similar commentary in ¶2.142 regarding the same issue.

The Draft in ¶2.133 discusses that an appropriate level of segmentation of a taxpayer's accounts is needed in order to exclude from the denominator costs that relate to other activities or transactions. VNO-NCW in principle agrees with this view, but consideration should be given that segmentation of accounts is very difficult in practice and may lead to discussions with tax authorities. Further guidance is welcomed on the application of segmentation of accounts.

The Draft in ¶2.136 discusses the issue of what type of costs should be included in the cost base when applying the TNMM. The Draft notes issues with the use of actual costs, while VNO-NCW believes that actual costs is often applied in practice given that comparables selected to set the transfer prices report actual costs and therefore provides for an appropriate comparison. VNO-NCW suggests further guidance to be given and to include a statement noting that actual costs, as well as standard or budgeted costs may be appropriate to use as the cost base depending on the facts and circumstances of the case.

The Draft discusses a number of profit level indicators while in ¶2.139 other possible net profit level indicators are discussed. VNO-NCW requests for clarification how the mentioned profit level indicators in ¶2.139 will be applied in practice.

Furthermore, the Draft seems to recognize only a limited number of profit level indicators, as well as a certain hierarchy in the use of the profit level indicators. VNO-NCW wants to emphasize that other than the mentioned profit level indicators may be applicable and would like to request the Draft to add the wording that the reference to specific profit level indicators is for illustration purposes only, where other profit level indicators may be appropriate as well depending on the facts and circumstances of the transactions.

The Draft reinforces the issue of the use of non-transactional third party data in ¶2.144. In the same paragraph it is mentioned that in case it is impossible in practice to achieve the transactional level set out as the ideal by the Draft, it is still important to achieve the highest level of comparability possible through making suitable adjustments based on the evidence that is available. VNO-NCW requests for clarifications regarding what the highest level of comparability possible means and what suitable adjustments could be made. In this respect, VNO-NCW believes that qualifying the level of comparability to *reasonably reliable* would be more in line with the burden put on the taxpayers to justify arm's length pricing.

CHAPTER III COMPARABILITY ANALYSIS

The Draft discusses a typical search process in ¶3.5 and considers this to be good practice to follow. VNO-NCW expresses the concern that this process is

regarded to be the standard for comparability searches and if taxpayers want to apply another process then this would be viewed with suspicion. VNO-NCW requests the Draft to provide for explicit language that the search process in ¶3.5 should be viewed as an accepted good practice but that any other search process leading to the identification of reasonable reliable comparables is just as acceptable. This also in view of expected compliance costs.

¶3.22 notes once a particular one-sided method is chosen as the most appropriate method and the tested party is the domestic taxpayer, the tax administration generally has no reason to further ask for financial data of the foreign related party. VNO-NCW strongly supports this approach. VNO-NCW even proposes to use stronger wording in this respect to only allow requesting for foreign related party information if tailored to the transaction.

The Draft introduces in ¶3.40 the "additive" approach for selecting potential comparables. VNO-NCW asks OECD for additional clarification on the perceived possibilities of the use of such an "additive" approach. The example of a combined "deductive" and "additive" approach mentioned in ¶3.44 raises questions, because in VNO-NCW's experience it is not common that large MNEs, with few MNE competitors in the branch, supplement and include these known competitors in a "deductive" approach, given these competitors often have significant intercompany sales. Allowing a combination of a "deductive" and "additive" approach creates uncertainty for taxpayers being confronted with potential comparables by tax authorities based on other sources than customary used following a "deductive" approach. VNO-NCW finds this undesirable.

The range concept is described as of ¶3.54. There it is mentioned that a range of arm's length figures is acceptable and in case some comparability defects remain that cannot be identified and/or quantified it might help to enhance the reliability of the analysis by using statistical tools (e.g. the interquartile range or other percentiles). This seems to indicate that every point within the interquartile range is arm's length. However, in case the relevant conditions of the controlled transaction (e.g. price or margin) fall outside the arm's length range, under certain circumstances, it may be appropriate to use measures of central tendency (for instance the median, the mean or weighted averages, etc) in determining the point to which the adjustment is made. VNO-NCW feels that the measures of central tendency are applied twice in this case and are therefore excessive. VNO-NCW requests the Draft to clarify that every point within the range is acceptable as an arm's length price (rather than to use the median, mean or weighted average).

¶3.63 of the Draft states that an independent enterprise would not continue loss-generating activities unless it had reasonable expectations of future profits whereby the statement is added that this doesn't mean that loss-making transactions can never be comparable. VNO-NCW strongly agrees

with this view as excluding comparables only because they are loss-generating, without taking into account all relevant facts and circumstances could potentially result in the rejection of at first comparable companies.

On "the arm's length price-setting" approaches noted in ¶3.68, VNO-NCW is concerned that the administrative burden will increase taking all considerations into account. In many cases, taxpayers establish transfer pricing documentation to demonstrate that they have made reasonable efforts to comply with the arm's length principle at the time their intra-group transactions were undertaken, based on information from previous years that was available to them at that point. VNO-NCW would like to insert into the text that the use of information from previous years is fine as long as taxpayers use information of consecutive years representing the economic cycle of the product over time.

In ¶ 3.70 it is mentioned that arm's length price-setting and the arm's length outcome-testing approaches, as well as combinations of these two approaches, are found among OECD member countries. VNO-NCW supports that OECD member countries should use their best efforts to resolve double taxation issues regarding these two approaches. However, VNO-NCW prefers more guidance on arm's length price setting and arm's length price outcome, to prevent double taxation arising in the first place.

¶3.72 notes for transactions with valuation uncertainties, that tax administrations would be justified in determining the arm's length price for the transaction on the basis of the adjustment clause or re-negotiation. The mere existence of uncertainty should not require an *ex post* adjustment. VNO-NCW strongly supports the latter. VNO-NCW on the other hand is concerned that the current wording might trigger significant discussions between taxpayer and tax administrations, therefore VNO-NCW suggests stronger wording to express that ex post adjustments can only be applied if it is very obvious that in a comparable uncontrolled transaction this would also be the case.

VNO-NCW in ¶3.81 welcomes the remarks that a detailed comparability analysis might not need to be done every year for simple transactions that are carried out in a stable environment and the characteristics of which remain the same or similar. However, following the same logic, VNO-NCW believes that financial information on comparables needs not to be updated annually either and therefore requests the Draft to amend the text to reflect this point.

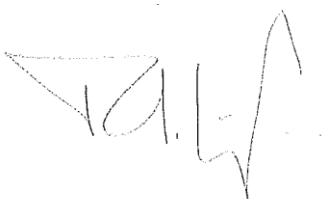
CLOSING REMARKS

VNO-NCW is generally supportive of the approach taken in the Draft. However, as mentioned above, a number of issues require careful consideration as without addressing them they will result in discussions

between taxpayers and tax authorities, a significant increase in administrative burden and cost, and may lead to double taxation.

VNO-NCW is prepared and looks forward working together with the OECD with the aim to provide clarity, reduce occurrences of friction between taxpayers and authorities, eliminate double taxation and lower compliance costs for taxpayer and authorities.

Yours sincerely,



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