

Organisation for Economic Cooperation and  
Development (OECD)  
Transfer Pricing Unit  
Centre for Tax Policy and Administration  
2, rue André Pascal  
75775 PARIS Cedex 16  
FRANCE

**Dr. Xavier Ditz**  
Tax Consultant  
Partner  
*xaver.ditz@fgs.de*  
Johanna-Kinkel-Straße 2-4  
53175 Bonn  
telephone +49 228 9594-226  
telefax +49 228 9594-100

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## **Comments on the Discussion Draft on Transfer Pricing Comparability Data and Developing Countries**

Dear Sir or Madam,

Thank you very much for the opportunity to comment on the Discussion Draft on Transfer Pricing Comparability Data and Developing Countries of 11 March 2014. We are firmly committed to the success of this project and are pleased to assist in its development. We would like to share a few thoughts with you based on practical experience gained in the context of advising multinational enterprises in matters involving transfer pricing, dispute resolution and exchanges of information.

### **General Comments**

The OECD confirms the application of the arm's length principle for the purposes of assessment of transfer pricing in transactions with parties in developing countries instead of the use of a formulary apportionment. We welcome the OECD's intention to provide more guidance on the application of the arm's length principle if there is a lack of available comparables. In our view, however, there is a significant risk that the Discussion Draft might result in misinterpretations of the internationally accepted arm's length principle in favor of the application of formulary apportionment by tax administration.

In our opinion, the following issues must be taken into account:

- Comparables collected by tax authorities must be made publicly available without any breach of the principle of secrecy in tax matters.
- The use of comparables from other geographic regions or other industries may result in double taxation if no further guidance is provided for the computation of country/industry-related comparability adjustments.
- Transfer prices are not suitable for use as anti-avoidance mechanisms, but should be determined in a consistent manner.
- Barriers regarding the application of mutual agreement procedures exist and must be addressed.

## **Detailed Comments**

### **1. Expanding Access to Data Sources for Comparables**

One major aspect of the lack of comparable data is that relevant information simply does not exist. Therefore, as discussed by the OECD, one option could be to increase filing obligations for financial data of companies within developing countries. However, such obligations should be introduced with all due care to avoid extensive new compliance burdens, especially in the case of small and medium sized companies in developing countries. Any new statutory reporting requirements should therefore include an escape from such obligations for small and medium sized companies.

If authorities within developing countries are to be encouraged to collect comparable information from tax returns and tax audits, it should be ensured that the principle of secrecy in tax matters will be kept. Moreover, it is obvious that such comparable information would be relevant for all taxpayers for the determination of transfer prices at arm's length as well. The information from any such database must therefore be made publicly available. It would be possible to take advantage of experience gain in this connection by, for example, the Australian Tax Office, which has been collecting and making available industry-related and function-

specific financials on taxpayers for several years (e.g., interquartile range, mean and averages of margins as so-called taxation statistics).

## **2. More Effective Use of Data for Comparables**

Taxpayers and tax auditors must acquire the skills and experience needed to effectively apply the arm's length principle. The proposal that tax officials of developing countries attend (in-house) training sessions of tax consulting firms, foreign tax authorities and international organizations is reasonable. Such sessions would enable tax auditors to share their experience and concerns with tax consultants and vice versa in order to avoid misunderstandings.

Such exchanges of experience are required in particular if comparables from the same industry but from other geographic regions are to be applied for the purposes of determination of arm's length transfer prices. This approach seems to be reasonable, but guidance would be required for any country-related comparability adjustments to be computed. For instance, clarifications might be helpful if adjustments are based on sector indices. If companies within the construction industry in a developed country earn a margin of 5% in average and the relevant index for a developing country shows a margin of 7%, the profit mark-up of a contract/toll manufacturer within the construction industry in a developed country (e.g. 4%) could be increased proportionately for a toll/contract manufacturer within a developing country ( $5.6\% = 4\% + 4\% * (7\% - 5\%) / 5\%$ ). However, other computations are feasible as well. As a consequence, double taxation might occur if comparability adjustments are computed in a different way.

Furthermore, it was suggested that comparables from other industries in the same geographic market should be applied to determine arm's length transfer prices. It is our opinion, however, this could result in double taxation as well since industry-specific comparability adjustments might be computed in different ways due to misinterpretations of sectoral differences.

Moreover, it has been proposed that – in the absence of local or regional comparables – the non-routine transaction's counterparty be accepted as tested party if it is located in a developed country for which financial data might be available. We do not expect that this could provide better results because the determination of comparable data for non-routine (especially entrepreneurial) companies is not only a complex issue; relevant information does not in fact exist in most cases.

### **3. Separate Anti Avoidance Mechanisms**

It has been proposed that the arm's length principle be replaced, e.g., by the application of the "sixth method" and the denial of the tax deduction of expenses, if jurisdictions with low or zero tax rates are involved in transactions. We are of the opinion that transfer prices are unsuitable for use as anti-avoidance mechanisms. Rather, the arm's length principle should be applied in a consistent way, while separate rules should be reserved for anti-avoidance mechanisms (like CFC rules).

### **4. Approach to Reduce Reliance on Direct Comparables**

We concur with the opinion of the OECD to the effect that formulary apportionment should not be an option or alternative to the use of the arm's length principle. Alternative "innovative" approaches for the application of the arm's length principle to transactions that do not rely on comparables must be developed and applied in a coordinated manner.

### **5. Mutual Agreement Procedures**

Mutual agreement procedures (MAP) are time-consuming and cost-intensive for both taxpayers and tax administrations. They do not therefore represent a viable option that would permit proactive determination of arm's length transfer prices by taxpayers. However, MAP (or better arbitration procedures) are required to avoid double taxation in the event transfer pricing adjustments are imposed by any tax authority. While almost all tax treaties agreed by (developing) countries include a provision similar to Article 25 of the OECD Model Convention, many such treaties do not include a provision similar to Article 9(2) of the OECD Model Convention. In this case, many (developing) countries are prevented from initiating MAPs according to experience at the practical level. We recommend providing guidance to the effect that MAPs should be implemented even if a provision similar to Article 9(2) of the OECD Model Convention is not agreed upon by the contracting states, but the tax treaty includes a provision similar to Article 25 of the OECD Model.

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We are looking forward to further progress and hope that these brief remarks will contribute to the further discussion of the topic.

Yours sincerely,

Dr. Xaver Ditz

Dr. Sven-Eric Bärsch

Dr. Sven Kluge