UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

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VIA EMAIL

Mr. Pascal Saint-Amans
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Re: USCIB Comment Letter on the OECD Discussion Draft on Transfer Pricing Comparability Data and Developing Countries

Dear Mr. Saint-Amans,

USCIB is pleased to have an opportunity to comment on the Discussion Draft on Transfer Pricing Comparability Data and Developing Countries. These comments supplement the BIAC comments on this Discussion Draft, which USCIB supports.

General Comments

USCIB supports the Discussion Draft's objective of strengthening application of the arm's length principle by providing guidance to allow tax authorities, particularly developing countries, and taxpayers access to information and tools to perform comparability analyses in a responsible, efficient way. Our comments below focus on ways to help achieve these shared goals. In the context of the BEPS discussions, the OECD has repeatedly said that the arms length standard needs to be improved in order to save it. While USCIB and business support improvements to the arms length standard, changes that fundamentally undercut it, in the purported interest of saving it, are not helpful. We are thus concerned about the direction of some of the suggestions in the Discussion Draft (discussed in more detail below).

Specific Comments

The Discussion Draft observes that commercial databases provide only limited information for much of Africa, Eastern Europe and South America and suggests working with the major suppliers of databases to ensure that the reasons for the limited coverage of developing countries have been accurately identified and explore options for improving developing country coverage and access. (Para. 13) USCIB supports this effort. Businesses would also benefit from improved databases, which would likely reduce transfer pricing disputes.

Paragraph 16 discusses the pros and cons of requiring companies to file statutory accounts and making that information available to the public as a way of expanding the availability of comparables data in developing countries and elsewhere. While each country must make its own decisions regarding companies' filing requirements, we think it imprudent to make that information available to the public.

Domestic laws[1] ought to protect companies from the harm that may result from the inappropriate disclosure of proprietary information such as accounting information, employment information, trade secrets, and other information that may be reflected in their statutory accounts. For example, disclosure of the margin earned by a contract manufacturing entity would provide competitors with information that they could use against the first company. .

Paragraph 17 of the Discussion Draft raises the possibility of tax administrations making use of data they collect to obtain comparables or to populate an internal (to the tax administration) database. This raises the concern over the use of secret comparables. USCIB has previously objected to the use of secret comparables as a matter of fundamental fairness. No one should be expected to rebut a position they are unable to replicate through an independent analysis. We are aware that tax authorities sometimes use broad industry average Profit Level Indicators to undertake risk assessment. This may be appropriate as a high-level risk assessment tool, but it is important that their use be limited to high-level risk assessment.

More effective use of data sources for comparables

USCIB agrees with the point that the proper use of a commercial database requires a degree of skill and experience. (Para. 18) These skills can be taught and might be an appropriate use of Tax Inspectors without Borders.

USCIB supports the notion of broadening the search for comparables to uncontrolled transactions in the same industry in other geographic markets (Para. 19). While this may add complexity to the comparability analysis, it is preferable to no comparability analysis or to an analysis based on insufficient data. Using these comparables will enable local tax authorities to gain experience with and assess the usefulness of these comparables and determine the nature of the adjustments that should be made. In the case of using comparables from another geographic market, perhaps countries could be encouraged to develop safe harbor comparability adjustments. That is, if country X routinely uses comparables from country Y and there are some features of that differ between those markets that require adjustment, the country X tax authority could develop standard adjustments to account for those features. Taxpayers could elect to use those standard adjustments to their comparability analysis. The OECD currently provides practical guidance for how to perform working capital adjustments. It would be very useful for the OECD to also issue practical guidance for how to adjust for geographical differences, such as cost of capital and country risk adjustments. The OECD could play a very positive "standard setting" role here.

USCIB also agrees that countries – including developing countries – should have access to information necessary to determine appropriate transfer prices. We believe that paragraph 3.18 of the current Transfer Pricing Guidelines has this right. That is, it is generally not appropriate to treat the foreign party as the tested party if it is not the least complex party to the related-party transactions. (Para. 22) Tax authorities should not be permitted to ignore sound local comparables – including internal comparables – if they are available. A contrary rule would invite tax authorities to treat as routine

[1] We are aware that domestic laws vary widely. We encourage the OECD to make sure that countries, particularly developing countries, take proper account of the issue of confidentiality in considering whether to adopt such rules. Lack of appropriate confidentiality rules can be a drag on investment if companies are concerned that disclosure of sensitive information. That is, the return on investment analysis will factor in possible losses from inappropriate disclosure of sensitive information, so it is important that this information be appropriately protected. Recommendations on appropriate domestic confidentiality laws could be a place where the OECD could play a standard setting role.

complex functions such as IP development, high-value services and at-risk manufacturing. In addition, confidentiality is important, so that, where such foreign information is used, countries must commit to protecting the information from inappropriate disclosure. Tax treaties provide safeguards that protect these interests, and while many developing countries do not have comprehensive treaty networks, the MLAT is available to them. USCIB has made this point in previous submissions; the expectation of access to information requires a corresponding obligation to protect that information.

USCIB generally agrees that the guidelines require identification of the most reliable comparables, even though they may not be perfect. That search may require benchmarking other industries in the same market or the same industry in different markets. (Para. 23) Paragraph 23 also states that sector averages and consolidated global returns may need to be considered. It is not clear what this means, particularly in light of the rejection of formulary apportionment in the next paragraph. How are the consolidated global returns to be considered, if not in a manner that would allocate a portion of those returns to companies participating in generating that return? If the sector averages and consolidated global returns are merely a check on whether imperfect comparables are in the right ballpark, then that may be appropriate. If that is intended to be the case, then it should be made clear.

Finding comparables for certain functions is a challenge not only in countries without databases, but sometimes in countries with databases as well. It is challenging, for instance, to find distribution comparables in China and India because of the nature of the market. The problem of having too few comparables and limited databases could be significantly ameliorated if the OECD were to develop reasonable guidance on how to adjust the financial results of companies in other countries to apply to the country of the tested party.

Similarly, for industries where finding appropriate comparables is generally a challenge, it would be very helpful for the OECD to issue guidance that makes clear that a company is not disqualified from serving as a comparable merely because it has intercompany transactions (so long as those transactions do not exceed a reasonable threshold). For example, in Korea and India, tax authorities allow companies to serve as comparables even though they have related party transactions provided that those transactions are not significant. The local databases for these countries provide information on the quantum of related party transactions that makes this analysis possible. (See appendix.)

Approaches to reducing reliance on direct comparables

Although paragraph 24 rejects the use of formulary apportionment, some of the suggestions in this section of the Discussion Draft seem to recommend a form of formulary in some cases.

USCIB believes that the Revised Discussion Draft on Intangibles takes too narrow of a view of a properly-administered one-sided analysis. Paragraph 151 provides that it is important not to assume that all residual profit, after a limited return for those providing routine functions, should necessarily be allocated to the owner of intangibles. In USCIB's view, this injects unnecessary complexity into the evaluation of transactions and parties that may very well be routine. While we recognize that some transfer pricing transactions may be difficult to value and that pricing must properly account for all functions, assets and risks that contribute to value creation, many transactions and parties are not entitled to a non-routine return. Affiliated enterprises should not be guaranteed a return that is higher than the return earned by comparable independent enterprises. We are very concerned that the Discussion Draft moves away from selecting the best method and introduces concepts that have no grounding in arms length principles.

Unfortunately, consistent with this failing in the Revised Discussion Draft on Intangibles, the Discussion Draft on Transfer Pricing Comparability and Developing Countries mentions economic analysis and global value chain analysis without providing any idea what these concepts might mean or how they might be applied. (Para. 25) In our view, it is inappropriate to suggest that these concepts might somehow be appropriate applications of the ALS without any further definition. Such a broad reference may encourage countries to take positions that are fundamentally at odds with the ALS and claim they are supported by the OECD. This will erode the ALS and lead to potential double and multiple taxation. In our view, these proposals undercut the ALS and do nothing to "save" it. For the same reason, we are troubled by the reference in this paper to the further work being done as part of the BEPS Action Plan to "clarify" the application of the profit split method. There is already a trend among several countries to inappropriately default to use of a profit split method in order to claim a share of the residual profits when its use is not warranted under a traditional functional analysis. The OECD has so far failed to identify the problems in the existing guidance on choice of the profit split method as the most reliable transfer pricing method, and cryptic references to the need for further work to "clarify" its application would only seem to exacerbate the uncertainty and controversy created by its increasingly frequent inappropriate use.

Paragraph 25 also recommends the use of the profit split method as an alternative due to a lack of comparables. However, even the application of the profit split method (using a residual analysis) requires data on comparables to allocate routine return as the first step. Similarly, the application of the profit split method using a contribution analysis is often dependent on comparable data. See relevant extract from the OECD transfer pricing guidelines:

> *"2.110 Where comparables data are available, they can be relevant in the profit split analysis to support the division of profits that would have been achieved between independent parties in comparable circumstances. Comparables data can also be relevant in the profit split analysis to assess the value of the contributions that each associated enterprise makes to the transactions..."*

For tax administration with limited resources, the increasing application of the profit split method may prove to be more challenging than making reasonable adjustments to regional or other comparable data.

USCIB strongly supports the OECD's effort to encourage the use of safe harbors, particularly bilateral safe harbors. Safe harbors need to be elective, should be based on the ALS, and should eliminate the need to provide transfer pricing documentation with respect to the covered transactions.

For the reasons the OECD so clearly sets out in paragraph 27, USCIB does not support the use of the so-called sixth method. In addition, large swings in commodity prices could result in upward adjustments without correlative adjustments and may create customs issues.

Advance pricing agreements and MAP

USCIB strongly supports the availability of APAs and MAP to resolve transfer pricing disputes. In particular, bilateral APAs offer the possibility of resolving issues before they become contentious and allow taxpayers to have certainty with respect to their pricing, accounts, and tax returns. Appropriate MAP procedures, including mandatory binding arbitration, are critical to a fully functioning transfer pricing system. Disputes will arise. Unless there is an effective way to resolve them, double taxation will result, with the attendant harm on foreign direct investment and bilateral trade. So, USCIB strongly supports the efforts of the OECD to assist developing countries in establishing fully functioning APA and

MAP programs, and allowing competent authority disputes to be resolved through mandatory, binding arbitration.

The OECD should be considering simplified procedures for small taxpayers and transactions. Such simplified procedures might represent a useful starting point for developing countries that are beginning their transfer pricing journey. The MEMAP may also provide useful guidance to developing countries on setting up and running an effective MAP program.

Summary

As indicated above, USCIB supports the many suggestions directed at finding better information to implement the ALS. However, some of the suggestions under item 3-- approaches to reducing reliance on direct comparables -- potentially move away from the ALS. Paragraph 24 reiterates the OECD's rejection of formulary apportionment as a replacement for the ALS. Nevertheless, the draft provides "alternative approaches to evaluating transactions that do not rely directly on comparables exist and may be required." The suggested alternatives include: the application of economic analysis or value-chain analysis, and the use of a so-called "sixth method". None of these methods is appropriate, in part because they lack definition, but primarily because they only by chance produce results that are consistent with a well-developed application of the ALS.

Sincerely,

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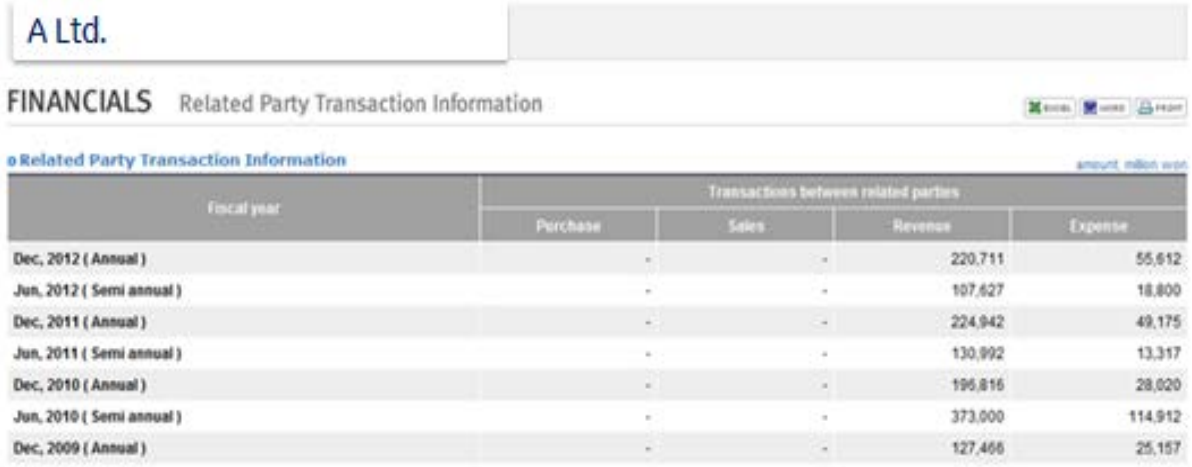
Appendix: Example of identifying related party transactions

When searching for comparable companies engaged in engineering and technical services in Korea, one finds a company ("A Ltd.") that is part of the A group. This company is accepted as a comparable as its ratio of intercompany purchase and expense to cost of goods sold is less than 25% and its ratio of intercompany sales to total sales in also less than 25%. Here is a screenshot of how the quantum of related party transaction is made available in the database:



A Ltd.

FINANCIALS Related Party Transaction Information

o Related Party Transaction Information

amount: million won

Fiscal year	Transactions between related parties			
	Purchase	Sales	Revenue	Expense
Dec, 2012 (Annual)	-	-	220,711	55,612
Jun, 2012 (Semi annual)	-	-	107,627	18,800
Dec, 2011 (Annual)	-	-	224,942	49,175
Jun, 2011 (Semi annual)	-	-	130,992	13,317
Dec, 2010 (Annual)	-	-	196,816	28,020
Jun, 2010 (Semi annual)	-	-	373,000	114,912
Dec, 2009 (Annual)	-	-	127,466	25,157