

COMMENTS RECEIVED ON
DOCUMENT FOR PUBLIC REVIEW

**CONFORMING AMENDMENTS
TO CHAPTER IX OF
THE TRANSFER PRICING
GUIDELINES**

24 August 2016



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**Changes to Chapter IX of the OECD Transfer Pricing Guidelines
"Transfer Pricing Aspects of Business Restructurings"**

Dear Sir or Madam,

We highly appreciate OECD's invitation to review the document "Conforming amendments to Chapter IX of the Transfer Pricing Guidelines". We thank the authors for the work they have done, and also we would like to thank the OECD for continuing the work on this topic. We very much welcome the further development of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

We welcome the redesign of the chapter and the related clarifications. At the same time the broad variety of cases and examples described in the paper shows, that each restructuring has to be assessed with an individual approach. In addition to the guidance given we would like to ask for an agreement procedure for the values used for tax purposes by the countries involved.

Paragraphs 9.40 f. explicitly point out that "profit potential" means "expected future profits". And "In the context of business restructurings, profit potential should not be interpreted as simply the profits/losses that would occur if the pre-restructuring arrangement were to continue indefinitely." From a business point of view it's not in line with the arm's length principle that the country of a taxpayer being restructured should have the right to tax profits which would never occur without the restructuring and no assets or functions being transferred out of the country.

Furthermore par. 9.26 concedes that expected synergies – which are a major motivation for restructurings and thus part of the profit potential – do not always materialize. In consequence even the correct application of the arm's length principle is associated with a high degree of uncertainty regarding the calculated value of the business restructuring.

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To reduce the risk of double taxation we suggest to add a link to Chapter IV “Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes” of the OECD Transfer Pricing Guidelines. We are quite aware that the OECD MAPs are not binding. However, we’d like to refer to the EU Anti-Tax-Avoidance Directive (Council Directive (EU) 2016/1164). Article 5 §5 states “Where the transfer of assets, tax residence or the business carried on by a permanent establishment is to another Member State, that Member State shall accept the value established by the Member State of the taxpayer or of the permanent establishment as the starting value of the assets for tax purposes, unless this does not reflect the market value.” We suggest to take up a similar recommendation which should be as binding as possible.

Please do not hesitate to contact us if you have any questions.

Yours sincerely



Berthold Welling



Ralph Brügelmann

The BEPS Monitoring Group

Comments on the Public Discussion Draft on CONFORMING AMENDMENTS TO CHAPTER IX OF THE TRANSFER PRICING GUIDELINES

These comments have been prepared by the [BEPS Monitoring Group](#) (BMG). The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. These comments have not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. They have been drafted by Jeffery Kadet, with contributions and comments from Tommaso Faccio and Sol Picciotto.

SUMMARY

Chapter IX was introduced into the OECD Transfer Pricing Guidelines (TPGs) in 2010 to help deal with the consequences of the spread since the 1990s of corporate restructurings by multinational enterprises (MNEs) essentially aimed at tax avoidance, typically involving transfers of rights to intangibles, redesignation of the responsibilities or functions of affiliates, and notional reassignments of risk-bearing. This draft rewrites the chapter to bring it into line with the other changes to the TPGs resulting from the BEPS project.

Our comments suggest ways in which the draft should be revised to make its purpose clearer, with additional coverage of restructurings that are only contractual in nature or that involve insubstantial movements of assets, people, and risks. It should state that the burden of proof is on the taxpayer to establish the validity and substantive nature of any stated business reasons behind any business restructuring, and should bring out more clearly the applicability of the profit split method.

GENERAL REMARKS

1. One-sided feeling

Since the late 1990s tax consultancy firms have offered advice on corporate restructuring aimed at producing tax savings.¹ These often entail few substantive changes to the actual organisation of the main business activities of a multinational enterprise (MNE). They should be distinguished from restructurings driven by considerations of the business itself, involving significant transfers of real activities, plant closures, etc. Instead, tax-motivated restructurings typically involve transfers of rights to intangibles, redesignation of the responsibilities or functions of affiliates, and notional reassignments of risk-bearing. Such restructurings result from decisions of the central management of the MNE, although they are generally given legal form by changes in the contractual arrangements between the MNE's various entities in different countries.

As a partial response to the increase in such tax-driven restructurings, the OECD introduced a new chapter IX in its Transfer Pricing Guidelines (TPGs) in 2010. This Discussion Draft (DD) provides a rewritten version of that chapter, to bring it into conformity with the other changes in the TPGs resulting from the BEPS project. Perhaps as a result of the need to achieve consensus between a large number of countries, many of the changes have lacked clarity, and have left the Guidelines confusing and contradictory, as we and other commentators have pointed out. Our comments on this DD are limited to suggestions on how this particular chapter could be made clearer and more effective, in the context of the other changes already agreed by the OECD.

Reading this draft of Chapter IX feels to some extent like it has been written for the benefit of taxpayer MNEs rather than for the benefit of tax administrations, or even for the equal benefit of both. Chapter IX would be much more helpful to both taxpayers and tax administrations if it were more balanced, including additional coverage of restructurings that are only contractual in nature or that involve insubstantial movements of assets, people, and risks.

The draft chapter does include some statements that acknowledge the nature of many of the tax-driven notional reorganisations by MNEs which create illegitimate tax savings. Notably, para. 9.35 points out:

Business restructurings often lead MNE groups to implement global business models that are hardly if ever found between independent enterprises, taking advantage of the very fact that they are MNE groups and that they can work in an integrated fashion. For instance, MNE groups may implement global supply chains or centralised functions that may not be found between independent enterprises.

This understanding is reflected in the example in para 9.46 and the restructuring described in para 9.123. With these notable exceptions, the examples and situations included in the discussion assume 'real' restructurings where assets, people, and functions move from one group member to another. This even results in the absurdity of

¹ Notably PWC's Global Tax Optimization Program, which offered "a coordinated, tailored approach to achieving [a company's] lowest sustainable tax rate" (US Senate, Permanent Subcommittee on Investigations, "Caterpillar's Offshore Tax Strategy" (2014), p.42).

accepting that MNE restructurings may comply with the arm's length principle even if no comparables can be found between unrelated firms. For example:

It should be noted that the mere fact that an arrangement is not seen between independent enterprises does not in itself mean that it is not arm's length nor commercially irrational. (Para. 9.109).

... There are also cases where comparables data are not found, for instance where the restructuring has led to fragmentation of integrated functions across several group companies in a way that is not found between unrelated parties. This does not necessarily mean that the conditions of the controlled transaction as accurately delineated are not arm's length. (Para. 9.113).

We suggest that the draft should be rewritten to bring out much more clearly the nature of tax-driven restructurings by MNEs which involve merely notional changes in the ownership of rights in intangibles and allocation of risks. They should stress the need for tax authorities to understand the facts and circumstances, and should place squarely on taxpayers the burden of proof to establish the bona fides of their actions.

SPECIFIC REMARKS

1. Expanding mention of the profit-split method

One outcome of the entire BEPS process is that there is recognition that the transactional profit-split method will have increased importance in the future. With this in mind, whether through footnotes or addition explanation, the possible applicability of this method in connection with Chapter IX matters would be useful to taxpayers and tax administrations alike. Presently, this method is only mentioned at the very end of the document in paragraph 9.131. There are other locations where it might usefully be mentioned as well. One excellent example is para 9.113.

2. Burden of proof concerning business reasons

Paragraph 9.4 comments on reasons reported by business for restructuring. There are of course many potential commercial and non-tax legal reasons for conducting business restructuring. Too often, though, stated business reasons for corporate structure changes are only facades for what is primarily a tax motivation. We strongly suggest that Chapter IX make clear that tax administrations should view purported business reasons with a healthy degree of scepticism. Further, Chapter IX should state that the burden of proof is on the taxpayer to establish the validity and substantive nature of any stated business reasons behind any business restructuring.

3. Financial capacity

This Chapter IX draft refers some number of times to the “financial capacity” of a party. (This term is defined in para 1.64 of the Guidelines.) While we do not suggest that this concept can never be important and relevant, in this Chapter on business restructuring, there must be some additional explanation given to alert tax administrations that the relevance of financial capacity must be carefully considered in each situation.

Often, and especially in any business restructuring where an MNE is shuffling the assets, activities, and risks of its group member to accomplish one or more business and/or tax

goals, the actual financial capacity of any particular group member is totally at the discretion of the MNE. The MNE has full control to capitalize a group member, loan it funds, etc. As such, whether a particular group member does or does not have sufficient financial capacity to conduct certain activities, own certain assets, or take on certain risks is meaningless from the standpoint of analysing the actual conduct of the parties.

We recommend that explanation concerning this be either added in appropriate places via footnote or through additional explanation. Several examples of paragraphs requiring such guidance are paras 9.20, 9.21, 9.43, 9.51, 9.90, and 9.108.

4. Taxability of full-fledged distributor profits irrespective of limited-risk distributor status—Existence of DAPE

The example in para 9.46 provides an excellent illustration of how a distributor might be in varying risk/reward situations such that it would be more or less inclined to change the economic basis on which it operates. While we of course approve of the point being illustrated, the example seemingly implies, through silence, that only contractual changes are being made and that no significant people functions are moving out of the full-fledged distributor. Thus, as a distributor, it will continue in the future to make sales locally and to make normal distributor decisions regarding local marketing, promotion and advertising, which potential customers to approach, to whom and how much credit to extend, etc.

As we understand the example, with this formerly full-fledged distributor retaining all its functions, the only relevant trade-off is the relative level of commercial risk being undertaken and reward being earned, i.e., the risk of a distributor that will primarily either make money or lose money based on volume of goods sold as against a cost-plus or similar pricing model that will protect the distributor from any loss, no matter how low the level of sales might be.

In such a limited risk situation with this sort of pricing where the purchase and resale of the principal's products by the 'distributor' is in legal form only, the real effect is that the foreign principal has a dependent agent permanent establishment (DAPE). The Action 7 Final Report deals with 'commissionnaire arrangements and similar strategies'.

Paragraph 5 of that Final Report defines such an arrangement as:

... an arrangement through which a person sells products in a given State in its own name but on behalf of a foreign enterprise that is the owner of these products.
...

Whether through only a footnote or through more extensive discussion, this example must inform taxpayers and tax administrations alike that this type of arrangement will create a DAPE of the foreign principal. This will put both taxpayers and tax administrations on notice that where these full distributor functions are being conducted locally that the full distributor profits will be taxable in the local country either in the hands of the full-fledged distributor or in the combined hands of the limited-risk distributor and the DAPE of the foreign principal. All concerned must recognize this factor in their overall review of the effects of the business restructuring.

Consideration should be given as well for similar disclosure in the new business model that is described in para 9.51 and in the example provided in para 9.102.

Along this same line, we note with approval the inclusion of the following in para 9.108:

... The analysis should go beyond the label assigned to the restructured entity, as an entity that is labelled as a “commissionnaire” or “limited risk distributor” can sometimes be found to own valuable local intangibles and to continue to assume significant market risks...

This point is further emphasized in para 9.112 and found as well in para 9.121. Again, whether through a footnote or other explanation, para 9.108 and para 9.121 are good places to put taxpayers and tax administrations on notice that certain functions conducted by a limited risk distributor will cause a DAPE with appropriate profit being earned in the host country under the rules of Article 7.

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August 16, 2016

Ref: BEPS CONFORMING CHANGES TO CHAPTER IX OF THE OECD TRANSFER PRICING GUIDELINES

Dear Jefferson,

Thank you for the opportunity to comment on the *BEPS Conforming Changes to Chapter IX of the OECD Transfer Pricing Guidelines* ("the discussion draft") issued on 4 July 2016. Many of the amendments noted, accord with the OECD's focus on risk management as a determinant of value creation, and we appreciate that efforts have been made to condense the chapter, and to ensure that this revision is consistent with other BEPS changes.

On an administrative note, it would be extremely helpful for all commentators if revisions to guidance, such as those proposed in the discussion draft, could be released in a "tracked changes" version in addition to a plain text version. This would improve the efficiency of the review process, and would allow commentators to more effectively target their comments on the areas where there have been significant changes. This is particularly important given that several BEPS-related discussion drafts have been issued at the same time.

Whilst we understand that this discussion draft is not considered by the OECD to warrant broad consultation, we are concerned that it may be inappropriate to address "perceived" inconsistencies without a further opportunity to comment. Furthermore, we did feel that some of the changes on "real" inconsistencies went beyond what was required in order to bring Chapter IX in line with the BEPS recommendations. We have, therefore, outlined comments on several changes below, and would welcome a public consultation to discuss these issues further.

Again, we thank you for the opportunity to comment on this draft.

Sincerely,



Will Morris, Chair
BIAC Tax Committee

Summary comments

1. We agree with the OECD that changes to Chapter IX of the Transfer Pricing Guidelines (“TPG”) should only reflect the broader revisions to the TPG proposed as part of the BEPS project. We have not commented on changes from the old Chapter IX which are simply conforming, or which replace older formulations with revised but similar concepts. Within this response, we have first set out some general comments on the discussion draft, before exploring some specific changes in more detail.
2. BIAC welcomes the streamlining of Chapter IX, and agrees that the guidance should indeed reflect the principles established in the earlier chapters of the TPG, rather than reiterating them in significant detail.

Primacy of the arm’s length principle

3. During the initial development of this guidance and throughout the BEPS project, the OECD and governments have made clear that the arm’s length principle, properly applied, should be reinforced and reaffirmed rather than replaced.
4. With that in mind, it is important to maintain a focus on what the arm’s length principle is attempting to achieve: namely, a reflection of the realities of third party arrangements in transactions between controlled parties. We are disappointed that some elements of the discussion draft seem to impose approaches that do not fully conform with this principle. For example, the discussion draft emphasises consideration of the impact of a restructuring on pre-tax profits as an indicator of whether an arm’s length payment is needed (9.37), or whether the business purpose of the restructuring should be investigated in more detail (9.38).
5. We do not advocate that the guidance single out any aspect as more important than another, but instead, it would be more helpful to identify the broad range of factors that should to be considered as part of a restructuring to determine whether or not a payment is necessary in accordance with the arm’s length principle. We believe, therefore, that emphasising the pre-tax impact in this way is likely to create expectations of payments without those expectations being grounded in business practice (or solid economic principles).
6. In arm’s length business restructurings, each party may use a wide range of factors to determine their approach to a business restructuring. This would, for example, include the restrictions imposed by contractual terms and conditions, relative negotiating strength, the impact on pre and post-tax profit, market share, long term growth prospects amongst many other factors. Calling out one factor risks overlooking many of the arm’s length considerations that two third parties might take into account, therefore potentially imposing non-arm’s length requirements on controlled transactions. The commercial rationality of the transactions ought to be based on how two third parties would have approached a comparable restructuring under comparable circumstances. We do not believe that the TPG should explicitly mandate one indicator over all others, but we reiterate that third parties would not look to anticipated pre-tax profits as a determinative factor.

7. We are also concerned that the guidance could be interpreted as requiring “*arm’s length compensation*” for all participants to all business restructurings. In this regard, we note that Para 9.37 reads “*it is expected that an appropriate transfer price [...] would generally be available to provide arm’s length compensation for each accurately delineated transaction.*” Although BIAC acknowledges that an arm’s length price could be zero, and the use of terms like “*general*” do not mandate a payment, the tone of the paragraph seems to suggest that governments believe that arm’s length compensation payments ought to be expected in most cases involving restructuring. This could create an expectation from tax authorities that any minor change to the operation of any MNE ought to result in payment (“*that is, compensation for the post-restructuring arrangement plus any compensation payments for the restructuring itself*”). In this regard, BIAC would welcome more objective language to clarify that whether an arm’s length payment is (or is not) required, ought to be based on an objective assessment of the facts at hand. We do not believe that conclusions should be presupposed in the general terms. There are many examples of business restructurings between third parties where no compensation is due over and above what has already been contractually agreed (e.g. where a distributor contract is cancelled with minimal notice, in accordance with the terms and conditions agreed by the parties, the only compensation due for the restructuring of the contract would be the notice period itself).

Economic potential (rather than profit potential)

8. Transfer pricing outcomes must apply equally to profits and losses. Although this is noted in some instances within the draft, it is not clear throughout. At numerous places the term “profit potential” is used - “economic potential” would be more accurate to reflect that either profits or losses could be generated as the result of a restructuring.

Compliance requirements

9. BIAC has a general concern about the level of documentation that will be required to comply with the draft guidance. We have highlighted some examples where the guidance will place an increased, and undue, compliance requirement on business in our comments on specific changes.
10. Many taxpayers are concerned about their ability to comply with the increasingly complicated TPG. The transfer pricing changes proposed under Actions 8-10, in addition to the documentation requirements under Action 13, will impose a substantially increased compliance burden on all MNEs. That compliance burden doesn’t just relate to the volume of documentation required, but also to the complexity and detail of the analysis needed to feel confident that the terms and conditions of a related party transaction, as well as the conduct of the parties, can be robustly defended. Given that the arm’s length principle will, by its nature, continue to be subjective, increasing the complexity of its application significantly drives up the compliance burden, without necessarily mitigating the risk of dispute. The additional level of detail taxpayers must provide may not reduce ambiguity for tax authorities about the appropriateness of the transfer price; rather the result may be a wider range of potential outcomes.
11. Indeed, the level of detail that seems to be required from the discussion draft in relation to all business restructurings would appear to give tax authorities an overly wide range of

opportunities to challenge whether a taxpayer is ‘compliant’ – even when the taxpayer has made a best-efforts attempt – increasing the costs of both taxpayer and tax administration. Taxpayers’ resources are constrained (in terms of staff and budget to pay advisors) and complying with the strictest interpretation of the requirements set out in the revised TPG and this discussion draft will be challenging for many.

12. In relation to business restructurings, we believe it would be helpful for the TPG to acknowledge that some transactions will require very little or no analysis for tax authorities to feel comfortable than an arm’s length outcome has been achieved (e.g. where a related party distribution contract has been terminated early, where it has already been documented that the terms and conditions of the transaction are consistent with the arm’s length principle).
13. There is a real risk that the extensive documentation requirements, coupled with threats of punitive penalties for non-compliance under domestic legislation, will decrease the attractiveness of cross-border trade and investment in some circumstances.
14. It is also worth noting that implementing blanket compliance obligations, which are very challenging for taxpayers to meet and give tax authorities the grounds to open audits, does not necessarily contribute to a positive tax compliance culture. The OECD’s Centre for Tax Policy and Analysis has produced some excellent work on co-operative compliance models; such strategies require taxpayers to be transparent and responsive, and tax authorities to show a commercial understanding of the needs of business¹. Introducing compliance requirements that will be exceptionally difficult and/or exceptionally burdensome to meet completely undermines these approaches. Therefore, additional language within this guidance on the specific scope of what is required would be very welcome.

Business decisions

15. One final point BIAC would like to highlight is the shift in the OECD’s focus with regards to the reach of Chapter IX (and the TPG more broadly). We note in paragraph 9.34 the removal of the sentence *“MNE groups cannot be forced to have or maintain any particular level of business presence in a country”*. It cannot be reiterated strongly enough that any business is free to act in whatever commercial manner it sees fit within the constraints of the laws in the jurisdictions in which it operates. The omitted sentence is also in line with bilateral investment treaties.
16. The objective of the transfer pricing guidance is to ensure related party interactions are taxed in a way which is consistent with how unrelated party transactions are taxed. This guidance should not be used to exert requirements on business beyond this objective. It is not clear from the discussion draft why it was felt that this particular sentence should be deleted. We request that it be retained in the new TPG.

¹ *Study into the Role of Tax Intermediaries*, OECD, 2008, *Co-operative Compliance: A Framework*, OECD, 2013, *Building Tax Culture, Compliance and Citizenship*, OECD, 2015, and *Co-operative Tax Compliance: Building Better Tax Control Frameworks*, OECD, 2016

Comments on specific amendments to the guidance

Paragraph 9.2

17. Paragraph 9.2 sets out a number of scenarios that may constitute a business restructuring. The paragraph has been amended to include the following new language on functions as an example: *“The concentration of functions in a regional or central entity, with a corresponding reduction in scope or scale of functions carried out locally; examples may include procurement, sales support, supply chain logistics.”*
18. Although BIAC agrees that a change in functions may be a restructuring subject to the Chapter IX guidelines, in other cases a centralisation of certain functions should not be assumed to have the potential to materially impact profit/economic potential. More pragmatic guidance should be provided to clarify that such restructurings will not always have an impact on the transfer pricing outcome. As an example, where a related party entity provides routine back-office administrative services, it may well be consistent with the arm’s length principle that the service contract can be terminated at relatively short notice without any additional compensation. This would reflect the fact that the services are routine and widely available, that competition in the marketplace is high, and that the service recipient would have the lion’s share of the bargaining power. In such situations (i.e. where the service contract is terminated to transition to a different, perhaps more centralised service model), it would not be appropriate for extensive documentation to be prepared to justify that no additional payment is required.
19. Further, some of the profits from services discussed in the newly added text refer to the same profits that are dealt with under Chapter VII on low-value intra-group services. The guidance should make clear that profit potential of some functions will be minimal and provide additional detail on how to treat those profits classified as low-value adding services under chapter VII.

Changes pertaining to the recognition of the actual transactions undertaken

Paragraph 9.16

20. This paragraph includes language which implicitly presupposes that there must always be some form of transfer pricing compensation for a restructuring. We propose the following amendments to this paragraph –

*“In order to determine **whether the arm’s length compensation should be payable upon a restructuring to any restructured entity within an MNE group, as well as the arm’s length value of this compensation and the member of the group that should bear any such compensation, it is important to accurately delineate the transactions occurring between the restructured entity and one or more other members of the group. For these purposes, the detailed guidance in Section D of Chapter I of these Guidelines is applicable.**”*

Paragraph 9.18

21. It is asserted in this paragraph that an “accurate delineation” of a business restructuring transaction requires a full functional analysis both before and after the transaction takes place.
22. Given the breadth of what can be considered to be a “business restructuring” we fear that this will be a very heavy – and disproportionate – requirement to place on businesses. Many taxpayers will simply lack the resources to comply with such an extensive obligation. This is especially pertinent given the increased complexity associated with applying the other chapters of the TPG which have been updated throughout the BEPS project.
23. BIAC believes it is important to note that some transactions that could be considered to be a “restructuring” would not warrant such an extensive review, and requiring such work from taxpayers in all cases would create a disproportionate compliance burden.
24. To provide an example, an MNE may have distribution agreements with a number of related party and third party entities. Those agreements may have been established on comparable terms and conditions, which would allow the engaging party to cancel the distribution contracts with 3 months’ notice with no additional compensation for the restructuring. If the MNE group has already documented and supported the arm’s length nature of the distribution services, it should not be necessary to undertake an excessive review of the ‘restructuring’ to determine that the result is consistent with the arm’s length principle.
25. The same concerns would also hold true with respect to contract manufacturing arrangements and long term supply arrangements involving both related party and third party entities, which have also been established on comparable terms and conditions. Generally these agreements would include details with respect to notification periods regarding contract termination as well as related penalties or termination costs. Other examples would include long term construction or installation contracts which involve change orders. Again, if the MNE group has already documented the arm’s length comparables which support the arm’s length nature of these types of arrangements, any changes which occur through a restructuring should not require extensive or excessive reviews to demonstrate that the result is consistent with the arm’s length principle.

Paragraph 9.22

26. The term “profit potential” is used throughout the draft. This paragraph uses the term “profit potential” to describe an indicator of economic risk. Rather than profit potential, we would prefer the use of the term “economic potential” or some other more neutral formulation to ensure that it adequately captures that risk entails the potential for both profits and losses and that this guidance should be applied consistently when businesses are in loss-making situations. Again, we believe that the TPG should take an objective view of related party transactions, and not establish an implicit expectation that there is always “profit potential” or a requirement for a further payment to be made to a restructured party.

Paragraph 9.30

27. Paragraph 9.30 explores the “options realistically available” hypothesis, and states that *“In such cases, an independent party may not have agreed to the conditions of the restructuring, and adjustments to the conditions made or imposed may be necessary.”* The guidance should expand on what taxpayers and tax authorities ought to do in such circumstances, i.e. where a restructuring has happened that one of the parties might not have agreed to it if it were between unrelated parties. An example would be very useful to illustrate this point, as it is not exactly clear what situations this sentence is looking to address. In this paragraph, it would be useful to reiterate again the importance of undertaking the analysis on an *ex ante* basis.

Paragraph 9.31

28. Paragraph 9.31 notes that taxpayers are not required to document all possible hypothetical options realistically available. At the same time, it indicates that if there is a realistic option that is clearly more attractive to an individual entity, it should be considered in the analysis of the restructuring. In order to determine whether there are any options clearly more attractive to each entity involved in a restructuring, taxpayers seem to be required to have done the analysis for all possible hypothetical options realistically available, so we believe this is an inappropriate recommendation. If this is the intention of the OECD, we would highlight that the broad range of hypothetical situations is likely to result in disagreements between tax authorities. An example might provide useful context for taxpayers to better understand what is meant by “clearly more attractive” – although, again, this will likely be subjective.

Paragraph 9.34 (previously 9.163)

29. The following sentences have been deleted from paragraph 9.34: *“MNE groups cannot be forced to have or maintain any particular level of business presence in a country. They are free to act in their own best commercial and economic interests in this regard.”*
30. This text should be retained in the new guidance as it does not relate to the broader changes to the TPG delivered through the BEPS project. As noted above, it is not clear why these sentences have been deleted. The TPG should not be used to impose non-arm’s length requirements on business. BIAC notes that there is a trend where some countries are acting on a unilateral basis to effectively mandate how multinational companies should operate as a commercial matter within their borders. This is being achieved through the use of domestic law and regulation, based on the specific economic objectives of the country. Although BIAC does not support the adoption of such restrictions as a general principle, whether or not to apply such laws is a decision for the country itself. BIAC does not believe that the TPG should implicitly or explicitly endorse restricting the re-organisation of a business, and should continue to state that a business is free to organise itself in the most appropriate way to deliver its commercial objectives within the confines of the law.

Paragraph 9.37 (previously 9.178 and 9.179)

31. These changes relate to the relevance of a tax purpose in a business restructuring. Both the discussion draft and current version of Chapter IX make it clear that domestic anti-abuse rules are not within the scope of the TPG. So, domestic rules that require a non-tax business purpose for a restructuring are not implicated by the guidance.
32. This paragraph also includes language which implicitly presupposes that there must always be some form of transfer pricing compensation for the restructuring. As noted above, this approach is not in line with the arm's length principle and, if retained, would put an undue compliance burden on business, and could lead to tax authorities regularly asserting that compensation is due post-restructuring, leaving a taxpayer exposed to the risk of double taxation if a corresponding adjustment cannot be obtained.
33. The significant changes to the paragraph are in the following sentence: *"Where a restructuring **makes commercial sense** ~~is commercially rational for the MNE group as a whole on a pre-tax basis~~, it is expected that an appropriate transfer price (that is, compensation for the post-restructuring arrangement plus any compensation payments for the restructuring itself) would generally be available to ~~make~~ **provide** arm's length **compensation for each accurately delineated transaction comprising the business restructuring** for each individual group member participating in it."* (Deletions ~~struck through~~, additions **bold**.)
34. We disagree that the arm's length price should be determined solely on a pre-tax basis, and, as noted above, that there should be any expectation that an arm's length payment should "generally" be available. A true arm's length price is one which would be realistic in a transaction between unrelated parties. In such transactions we would expect each party to consider a wide number of factors in determining their position (including pre and post-tax income, amongst many other factors²).

Paragraph 9.38 (previously 9.181 and 9.182)

35. The first sentence of current paragraph 9.182, which reads as follows, has been deleted: *"Provided functions, assets and risks are actually transferred, it can be commercially rational from an Article 9 perspective for an MNE group to restructure in order to obtain tax savings."*
36. The retained language in the paragraph still makes clear that *"In making commercial decisions, tax considerations may be a factor"* and therefore we can see that the deleted sentence could be considered duplicative to an extent. However, we believe that the original wording was clearer and it is therefore our preference for it to be retained.
37. Further, the final (newly added) sentence of 9.38 discusses the example in 9.122-9.124, stating that: *"Moreover, as indicated in paragraph 1.122, the fact that a MNE group as a*

² Including (but not limited to): post-tax income, cash flow, geographical factors, market share, local expertise and cost, legal/regulatory requirements/obligations, reputation, exchange rate fluctuations, political stability, competition, available options, bargaining power, and impact on credit ratings.

*whole is left worse off on a pre-tax basis may be a relevant pointer in determining the commercial rationality of the restructuring.” While we appreciate that it only “may be” a relevant factor, this is not a useful addition to the guidance and is not helpful for taxpayers who require clear, practicable guidance. It also seems slightly incongruent with paragraph 9.26, which makes the point that there may be cases where a change to a business model designed to increase synergies will not lead to an outcome where the post-restructuring profits are higher than the pre-restructuring ones. There are many factors that can lead to this, ranging from poor forecasting to changes in economic conditions or unanticipated obsolescence.³ Accordingly we believe that the pricing should be based on *ex ante* information only. We believe that the TPG should be more explicit on the various other factors that, taken together, would help to inform a taxpayer and tax authority as to whether there is likely to be transfer pricing risk.*

Paragraph 9.46

38. We welcome the recognition that arm’s length responses will depend on both the economic and commercial environment and the relative position of the parties transacting, and, in particular, we welcome the following language –

“in evaluating profit potential, it is necessary to evaluate whether historic profits ..[.].. are an indicator of future profit potential, or whether there have been changes in the business environment around the time of the restructuring that mean that past performance is not an indicator of profit potential. For example, competing products could have the effect of eroding profitability, and new technology or consumer preferences could render the products less attractive. The consideration of these factors from perspective of the distributor can be illustrated with the following example.”

Paragraph 9.65

39. The additions to this paragraph are rather confusing and, in particular, the reference to “legal ownership” of local marketing intangibles seems to be at odds to the broader changes to the TPG. Per the OECD’s “something of value” approach to defining what is an intangible asset, it may well not be possible to transfer legal ownership of IP, as in fact, the “something of value” may not be capable of being legally owned or recognised for accounting purposes. This language confuses and further complicates the application of this part the guidance. BIAC recommends that this paragraph is reformulated to clarify that it applies where a local entity has developed local intangibles, but that the reference to legal ownership is clarified or removed to improve consistency.

³ For example, synergies that were anticipated or cost savings that were expected to arise by some decision makers sometimes do not, when implemented, achieve their objectives. There may be overwhelming market pressure to reduce employees (internal “headcount”) in a high-wage jurisdiction. The work will still have to be done, and may therefore be outsourced at greater cost (and/or less efficiency) than that incurred by the former employees.

Paragraph 9.84

40. We were pleased to see the new language in this paragraph, which illustrates again the limitations of the options realistically available comparatives –

“as in some situations, it may be the case that, in comparable circumstances, an independent party would not have had any option realistically available that would be clearly more attractive to it than to accept the conditions of the termination or substantial renegotiation of the contract. The guidance in Section D of Chapter I, as well as the Guidance in Section B of this Part, are applicable.”

Paragraphs 9.122- 9.124

41. These paragraphs outline an example where valuable intangibles are transferred to a shell company. In the current guidelines there is also an example (paragraph 9.193 Example C) where there is a transfer of an intangible for a tax purpose; in the example, this transfer is recognised, demonstrating the deleted sentence from paragraph 9.182⁴. BIAC believes that this example is useful and should be retained in the updated guidelines.
42. The deletion of this example creates uncertainty regarding the legitimacy of transactions which are rational on a post-tax rather than pre-tax basis and the example should, therefore, be retained for several reasons:
- a. Not recognising the transaction contradicts the principle that the result should not be different whether the transaction was originally structured in a particular way (which would clearly be respected) compared to if the parties restructure into it.
 - b. The TPG should be applied to the restructuring, and then the post-restructuring transactions. If this is applied appropriately then there should be no basis for a country to continue to tax income arising from activities that are undertaken in a different country.
 - c. We believe that if the tax benefits do not arise from a regime that is deemed a “harmful tax practice” (which has been addressed through BEPS Action 5 and the work of the Forum on Harmful Tax Practices), companies should be able to take advantage of them when dealing with third parties or related parties.
43. A changing of position of the legitimacy of transactions that make commercial sense on a post-tax basis would go beyond a conforming change to these guidelines and should not be included without due consideration, including an appropriate public consultation process.

⁴ In the example the trademarks are transferred together with the head office personnel that can make the strategic decisions and control the risks, therefore the new company has the financial capacity to bear the risks. The main reason for the group to enter into the restructuring is to benefit from a favorable tax regime. The conclusion is that the substance and the form go together and independent parties in comparable circumstances acting in a commercially rational manner would have done the same.

CBI RESPONSE TO THE OECD DOCUMENT FOR PUBLIC REVIEW “BEPS CONFORMING AMENDMENTS TO CHAPTER IX OF THE TRANSFER PRICING GUIDELINES”

As the UK’s leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

The CBI has supported the OECD BEPS project since its inception and recognises the need to update international tax rules to address base eroding and profit shifting activity.

We have reviewed the response prepared by BIAC in respect of the OECD document for public review “BEPS conforming amendments to Chapter IX of the Transfer Pricing Guidelines” and agree with the key points and conclusions set out in the BIAC response. In addition, we have set out below some comments specific to our members:

- There are many reasons for which a group would go through a restructuring process and there is already a lot of legislation around preventing a deduction unless the restructuring is undertaken for bona fide commercial reasons. It would be inappropriate for a company to be in a potential position of double jeopardy and risk having two disallowances. Furthermore, there is a wider question around whether a transfer pricing adjustment would be able to obtain a correlative adjustment under a double tax treaty.
- Restructuring is generally an exceptional cost of a company and therefore often is outside the transfer pricing testing on a comparative basis. There are arguments whether the restructuring should be included within multi-year testing as the benefits of the restructuring should flow through to the P&L account over time.
- There is a risk that some groups incur restructuring costs on a frequent basis and this may lead to a permanent distortion of the ability to test operating results against comparable entities. This is a frequent area of concern for many countries, including the UK. An entity should be prepared to be able to demonstrate why any restructuring costs should be excluded from operating results and also be able to demonstrate the enduring benefit which the cost is anticipated in having to its local trade. This issue can be more exacerbated where a group has low risk low margin functions in a particular country plus leaves all the restructuring costs in that country, hence raising the question whether an independent third party would have entered into such a transaction. This issue may become intertwined with the move to base transfer pricing on a value-added basis, but we would anticipate that restructuring costs and exceptional costs will be a long term debate.

16 August 2016

Mr Jeff VanderWolk
Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development

By email: TransferPricing@oecd.org

Our ref: WJID/AL

Dear Jeff

Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines

Thank you for the opportunity to comment on the Discussion Draft on *Conforming Changes to Chapter IX of the Transfer Pricing Guidelines* published on 4 July 2016 (the 'Discussion Draft'). These comments are written from the perspective of the UK.

The guidance in the Discussion Draft on risk and recognition of accurately delineated transactions is helpful for the interpretation and application of the arm's length principle in the context of business restructurings. However, in places the wording used in the Discussion Draft is unclear and could lead to unnecessary disputes between businesses and tax authorities and between different tax authorities.

It is important to note that third parties may choose to enter into a business restructuring if there were no clearly more attractive options realistically available to them. This does not mean that the business restructuring itself would need to be clearly more attractive than other options (eg where these are of comparable attractiveness). Businesses can choose how to structure their affairs as they see fit, as noted in paragraph 9.34.

The new term 'profit potential' (replacing 'profit') used throughout the Discussion Draft is a cause of potential uncertainty. The explanation of what this term means (currently at paragraph 9.40) should be brought to the front of the chapter to ensure that it is understood. In addition, it is essential that the definition of 'profit potential' gives adequate recognition to risk, and in particular to the possibility of losses in relation to higher-risk activities. For restructurings that involve changes to the risk profile of business activities it is important that the Discussion Draft make it clear that a reduction in risk and agreement to a lower but more certain return may be an appropriate business strategy at arm's length. It would be helpful to use a different term – perhaps 'economic potential' to ensure that all factors are given appropriate consideration. It would also be helpful if the Discussion Draft were to reference that this should be a two-sided analysis – it is equally important that the arm's length principle is applied to the entity that takes on increased risk in order to achieve a higher return, including consideration of the effect of any potential compensation payment on this analysis.

Detailed comments on specific aspects of the Discussion Draft are set out in the attached appendix.

If you would like to discuss any of the points raised in this letter, please do not hesitate to contact

either me (bdodwell@deloitte.co.uk) or Alison Lobb (alobb@deloitte.co.uk).

Yours sincerely,



W J I Dodwell
Deloitte LLP

Appendix 1: Detailed comments on confirming changes to Chapter IX of the OECD transfer pricing guidelines

'Options realistically available' (Part I, section B: Understanding of the restructuring itself)

At arm's length, third parties would enter into an arrangement if there is no clearly more attractive option realistically available. This does not mean that the arrangement entered into itself (the business restructuring) should necessarily have to demonstrate that it is clearly more attractive than alternatives. For example, it may be that alternatives are broadly equal in their attractiveness to the transactions actually undertaken, and therefore third parties would still choose to enter into the business restructuring. (To suggest otherwise would be inconsistent with the guidance on recognition of actual transactions as set out in the Actions 8-10: 2015 Final Report on Aligning Transfer Pricing Outcomes with Value Creation).

The Discussion Draft is ambiguous as it switches emphasis in different paragraphs as to whether it is the restructuring that needs to be **clearly** more attractive (paragraph 9.28), or whether it is one of the other options realistically available that needs to be **clearly** more attractive (paragraphs 9.27, 9.29 and 9.30).

In order to avoid disputes and potential double taxation paragraph 9.28 should be amended as follows (**bold** text added; ~~strikethrough~~ text deleted):

Thus, in applying the arm's length principle, the tax administration should evaluate each transaction as accurately delineated under the guidance in Section D of Chapter I and consider the economically relevant characteristics taken into account by the parties in reaching the conclusion that **there is no clearly more attractive opportunity available to meet commercial objectives than** the restructuring adopted ~~offers a clearly more attractive opportunity to meet commercial objectives that alternative options realistically available~~ (see paragraph 1.38). In making such assessment, it may be necessary or useful to assess the transactions comprising the business restructuring in the context of a broader arrangement of economically related transactions.

Further examples showing the application of 'options realistically available' would be helpful. It is also important to note that third parties would consider these options on an ex-ante basis, before entering into the transactions.

Compliance requirements (Part I, section B: Understanding of the restructuring itself)

In line with BEPS Action 13, paragraph 9.32 of the Discussion Draft specifies that all business restructuring transactions must be documented in the master file (Annex I to Chapter V) and the local file (Annex II to Chapter V).

It would be helpful to acknowledge that some restructurings will require little or no analysis to demonstrate that the arm's length principle has been achieved. This would be consistent with Chapter III (paragraphs 3.80-3.83) of the Transfer Pricing Guidelines and would help to alleviate unnecessary compliance for businesses that has no corresponding relevance for tax authorities

Arm's length principle (Part I, section C: Recognition of the accurately delineated transactions that comprise the business restructuring)

There are many cases of business restructurings between third parties where there is no compensation for the restructuring itself, but where the application of the arm's length price post-restructuring is sufficient. It would help if Paragraph 9.37 could be clarified in this respect to say that:

*... it is expected that an appropriate transfer price (that is, compensation for the post-restructuring arrangement plus, **if applicable**, any compensation payments for the restructuring itself) would generally be available to provide arm's length compensation...*

This would make clear that a compensation payment for the restructuring itself is not expected but may, nonetheless, be necessary.

The inclusion of examples of key economic and commercial factors to consider when assessing whether a compensation payment is required at arm's length may be useful for both businesses and tax authorities.

Profit potential (Part I, section D: Reallocation of profit potential as a result of a business restructuring)

Paragraph 9.40 appropriately sets out that 'in some cases it (profit potential) may encompass losses', Further examples of cases where profit potential does (or does not) encompass losses would be helpful.

There may be transactions (e.g. routine or low value adding activities) where, at arm's length, the profit potential (if any) is limited by the nature and extent of the transaction itself.

As a result, the term 'profit potential' should be replaced. A more neutral term such as 'economic potential' would be clearer for interpreting and applying the arm's length principle.

The example at paragraph 9.45 would benefit from some revisions. It assumes in its facts a very specific 'long-term contractual arrangement' in order, it appears, to conclude that a compensation payment is necessary. However, it does not discuss whether the long-term nature of the contract is, of itself, an arm's length term. It may be the case that it is not, for example in fast-moving industry sectors such as technology. It would be helpful to expand this example to consider other factors, including those pertinent to both parties to the business restructuring.

Mr. Jefferson VanderWolk
Head of the Tax Treaty, Transfer Pricing & Financial
Transactions Division
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2, rue André Pascal
75775 Paris Cedex 16

August 9th, 2016

Dear Mr. VanderWolk,

We have pleasure in detailing below our comments on the BEPS Document: *Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines*.

We have very few comments on the draft, but the following are made with reference to the paragraphs in the document in order to suggest further clarifications that the OECD might consider including in the final version of the guidance.

9.47. Commentary on and the Example given in 9.46

In general we find this example a little unhelpful in illustrating whether a distributor would accept a fixed future remuneration arrangement for no compensation. This is because it bases the analysis only on the past profitability of the distributor.

In our view a distributor would also take into consideration anticipated profitability over a reasonable forecast period of several years, where such data is available at the time of the restructuring. This would be a more realistic approach as a distributor would then be able to determine whether or not the risk of fluctuating future profits can be negated by agreeing to a consistent return, or whether an additional compensation payment should be negotiated.

The OECD may like to give consideration to amplifying the example for all three scenarios beyond its suggestion that it is only Scenario 3 that should take account of future profitability.

9.83. Comparables data for indemnification clauses

In this part of the paper the OECD may like to make reference to the existence of potential comparables data from commercial court cases, in supplement to the comments made in 9.80. For example, in France, there is significant jurisprudence relating to third party commercial agents as to what comprises a reasonable (and therefore arm's length) notice period in contracts for their termination, the absence of which, or an insufficiency thereof, gives rise to an obligation to pay compensation.

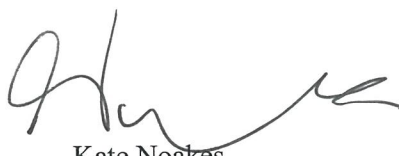
9.129. Location savings example

Whilst we agree with the conclusions of this example, it would be helpful if the OECD could provide an example(s) where location savings should be shared between Countries A and B and guidance on how such sharing should be determined. We note that in paragraph 9.131 reference is made to the transactional profit split method. Perhaps this can also be referenced in this paragraph.

* * *

We trust these comments are helpful to you and, as always, we would be happy to elucidate on them and to participate in future business consultations.

Yours sincerely,



Kate Noakes
Transfer Pricing Partner
FIDAL

INTERNATIONAL ALLIANCE FOR PRINCIPLED TAXATION

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16 August 2016

VIA E-MAIL

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Re: Comments on the 4 July 2016 Document Containing Draft Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines

Dear Sir or Madam,

The International Alliance for Principled Taxation (IAPT) is a group of major multinational corporations based throughout the world, and representing business sectors as diverse as consumer products, media, telecommunications, oilfield services, computer technology, energy, health care, beverages, software, IT systems, publishing, management consulting, and electronics.¹ The group's purpose is to promote the development and application of international tax rules and policies based on principles designed to prevent double taxation and to provide predictable treatment to businesses operating internationally.

The IAPT appreciates the opportunity to provide input to the OECD with respect to the Document containing draft Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines released by the OECD on 4 July 2016. Our comments are set forth in the Annex to this letter.

¹ The current membership of the IAPT is made up of the following companies: Accenture plc; Adobe Systems, Inc.; Anheuser-Busch InBev NV/SA; Cisco Systems, Inc.; The Coca-Cola Company; Exxon Mobil Corporation; Hewlett Packard Enterprise Company; Johnson & Johnson; Microsoft Corporation; Procter & Gamble Co.; REXL Group plc; TE Connectivity Ltd.; Thomson Reuters Corporation; Transocean Ltd.; Tupperware Brands Corporation; Vodafone Group plc; and Yum! Brands, Inc.

Sincerely yours on behalf of the IAPT,

A handwritten signature in dark ink, appearing to read 'C. Silberztein'.

Caroline Silberztein
Baker & McKenzie SCP
Counsel to the IAPT

Annex

ANNEX

INTERNATIONAL ALLIANCE FOR PRINCIPLED TAXATION

COMMENTS ON THE 4 JULY 2016 DOCUMENT CONTAINING DRAFT CONFORMING
AMENDMENTS TO CHAPTER IX OF THE TRANSFER PRICING GUIDELINES
16 AUGUST 2016

IAPT Comments on the 4 July 2016 Document Containing Draft Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines

1. Introduction

1. We are pleased to provide hereafter our comments on the 4 July 2016 Document containing draft Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines (hereafter “the Draft”).

2. We commend the OECD for producing the Draft in a timely manner soon after the approval of the Actions 8-10 Final Report by the Council. We recognise that in making those conforming changes, WP6 decided not to revisit the guidance on business restructurings but to focus attention on changes necessary to address inconsistencies, real or perceived, with the revised chapters, and to remove duplication. It would be helpful if the OECD could identify what it regards as perceived or real inconsistencies. Identification of “perceived” inconsistencies can be a very subjective exercise. As a general remark, we find that some of the proposed amendments to Chapter IX do not seem to be prompted by the need for consistency with the Actions 8-10 Final Report. The revision of Chapter IX should not lead to the deletion from the Guidelines of helpful guidance that is not inconsistent or duplicative, or to the addition of new guidance that goes beyond the Actions 8-10 Final Report.

3. In drafting our comments, we kept in mind the OECD request that the invitation to review should not be used as an opportunity to comment on aspects of the Guidelines which have been changed in the 2015 BEPS Reports or to comment on the guidance on business restructurings which is not affected by the conforming changes.

4. We hope that our comments will help the OECD further strengthen the internal consistency of the Guidelines.

2. Detailed comments

Section A.1 Business restructurings that are within the scope of Chapter IX

5. Paragraph 9.1 provides the definition of business restructurings that are within the scope of Chapter IX. Paragraph 9.2 contains illustrations thereof. This paragraph is amended to place the centralisation of functions at the same level as the centralisation of intangibles and risks as follows:

Business restructurings may often involve the centralisation of intangibles, risks, or functions with the profit potential attached to them.

6. An additional illustration of a “typical” business restructuring focussing on functions is included as follows :

The concentration of functions in a regional or central entity, with a corresponding reduction in scope or scale of functions carried out locally; examples may include procurement, sales support, supply chain logistics.

7. While the Draft includes a number of clear cross-references to the revised guidance on accurate delineation of transactions, risks and on intangibles, we believe that it is missing similarly

clear cross-references to the relevant guidance on transfers of functions. **We recommend including cross-references to the revised Chapter I guidance on assembled workforce (1.152-1.156), synergies (1.157-1.173) and revised Chapter VII guidance on services (especially 7.3, 7.14, 7.43-7.51).**

8. Such cross-references would in our view be very helpful to clarify for instance that the centralisation of functions in the context of a business restructuring should be assessed consistently with the general guidance in Chapters I and VII, including with respect to the question whether such centralised functions carry a significant profit potential, thus strengthening the internal consistency of the Guidelines.

9. In our view it would also be desirable to balance the **addition of this new bullet point with a clarification that the mere implementation of an intragroup agreement (implementation of a routine service agreement, distribution or manufacturing agreement, for instance) should not be regarded as a business restructuring** that triggers the sort of complex analysis set out in Chapter IX.

Section B Understanding the restructuring itself (role of comparables)

10. The last sentence of paragraph 9.13 reads as follows:

As stated in paragraph 1.33, these conditions and economically relevant circumstances of the accurately delineated transactions that comprise the business restructuring will then be compared with the conditions and economically relevant circumstances of comparable transactions between independent enterprises.

11. Consistently with the guidance at paragraph 1.11 of the Actions 8-10 Final Report, paragraph 9.35 of the Draft notes, in the context of the recognition of actual transactions, that :

Business restructurings often lead MNE groups to implement global business models that are hardly if ever found between independent enterprises, taking advantage of the very fact that they are MNE groups and that they can work in an integrated fashion. For instance, MNE groups may implement global supply chains or centralised functions that may not be found between independent enterprises. This lack of comparables does not mean that the implementation of such global business models is not arm's length. Every effort should be made to determine the pricing for the restructured transactions as accurately delineated under the arm's length principle. A tax administration should not disregard part or all of the restructuring or substitute with other transactions unless the exceptional circumstances described in paragraph 1.122 are met. In those cases, the guidance in Section D.2 of Chapter I may be applicable.

12. This cautionary language has broader implications than just for the recognition of transactions (as acknowledged at 1.11). We therefore suggest that the notion that the lack of comparables does not mean a transaction is not arm's length should be brought earlier in the Draft. **We suggest including this point at the end of paragraph 9.13.**

13. In fact, in our view, the role of comparables for the application of the arm's length principle, including in relation to business restructurings, is as follows:

(i) the existence of reliable comparables for a controlled transaction can support its consistency (or inconsistency) with the arm's length principle (demonstrating what independent parties *have* done), and

(ii) the lack of comparables does not of itself mean that the controlled transaction is not arm's length (but requires hypothesizing what independent parties *would have* done).

14. This was clearly indicated in the 2010 Guidelines in relation to risk at paragraphs 9.18-9.19:

B.2.1 Role of comparables

9.18 Where data evidence a similar allocation of risk in comparable uncontrolled transactions, then the contractual risk allocation between the associated enterprises is regarded as arm's length. In this respect, comparables data may be found either in a transaction between one party to the controlled transaction and an independent party ("internal comparable") or in a transaction between two independent enterprises, neither of which is a party to the controlled transaction ("external comparable"). Generally, the search for comparables to assess the consistency with the arm's length principle of a risk allocation will not be done in isolation from the general comparability analysis of the transactions with which the risk is associated. The comparables data will be used to assess the consistency with the arm's length principle of the controlled transaction, including the allocation of significant risks in said transaction.

B.2.2 Cases where comparables are not found

9.19 Of greater difficulty and contentiousness is the situation where no comparable is found to evidence the consistency with the arm's length principle of the risk allocation in a controlled transaction. Just because an arrangement between associated enterprises is one not seen between independent parties should not of itself mean the arrangement is non-arm's length. However, where no comparables are found to support a contractual allocation of risk between associated enterprises, it becomes necessary to determine whether that allocation of risk is one that might be expected to have been agreed between independent parties in similar circumstances.

15. Paragraphs 9.18-9.19 of the 2010 Guidelines are deleted in the Draft. While we understand the reasons for the deletion of paragraph 9.20 (given the notion of "relevant although non determinative factors" has been removed in the Actions 8-10 Final Report), we believe that the standard set at 9.18-9.19 is still valid. **We therefore suggest that paragraphs 9.18 - 9.19 should be reinstated, or that an explanation be provided as to why such paragraphs are found inconsistent with the Actions 8-10 Final Report.**

Section B.1 Accurate delineation of the transactions comprising the business restructuring

16. The first sentence of paragraph 9.16 can be misleading as it seems to suggest that each individual transaction should be positively compensated at arm's length. As acknowledged at paragraph 9.4,

[...] business restructurings may be needed to preserve profitability or limit losses, e.g. in the event of an over-capacity situation or in a downturn economy.

17. The determination whether an individual transaction comprised in a business restructuring should be compensated at arm's length should result from the application of the analytical framework provided in the Guidelines. As noted at paragraph 9.29,

At arm's length, there are situations where the restructured entity would have had no clearly more attractive option realistically available to it than to accept the conditions of the restructuring, e.g. a contract termination – with or without indemnification.

18. We therefore suggest that, to improve consistency with the rest of the Guidelines, **the first sentence of paragraph 9.16 should be revised** as follows :

In order to determine whether, at arm's length, compensation would be payable upon a restructuring to any restructured entity within an MNE group, and if so the amount of such compensation as well as the member of the group that should bear such compensation, it is important to accurately delineate the transactions occurring between the restructured entity and one or more other members of the group. For these purposes, the detailed guidance in Section D of Chapter I of these Guidelines is applicable.

Section B.1.1 Risk

Contract R&D and contract manufacturing

19. The 2010 Guidelines contain at paragraphs 9.25-9.27 a series of 3 examples illustrating the meaning of control over risk. The first example relating to a fund manager was revised and included in Chapter I at paragraph 1.70. The second and third examples, relating to a contract researcher and a contract manufacturer, were deleted.

20. We believe that these examples are consistent with the new guidance and are not duplicative. They illustrate the commonalities of the exercise of control in the three situations, and are helpful as in practice many disputes arise with respect to contract R&D and contract manufacturing. Deleting these examples may send the wrong signal as to their continued relevance. **We therefore suggest that the two deleted examples (9.26 and 9.27 of the 2010 Guidelines) be reinstated**, with the adaptations needed, if any, for full consistency with the Actions 8-10 Final Report.

Bad debt risk

21. The first bullet point of paragraph 9.21 provides the following new example:

For example, suppose a full-fledged distributor contractually assumes bad debt risks, which is reflected in the balance sheet at year end. However, the analysis described above establishes that before the business restructuring occurred decisions about the extension of credit terms to customers and debt recovery were taken by an associated enterprise and not by the distributor, and the associated enterprise reimbursed the costs of irrecoverable debts. It is determined that the associated enterprise controls the risk and has the financial capacity to assume the bad debt risk, leading to the conclusion that the risk is not assumed by the distributor. In such a case there is no risk for the distributor to transfer as part of the business restructuring.

22. We wonder what the intended consequences of such example are. We think that it can be read to imply that under the facts of the example, the change of contractual terms should not justify a decrease of the distributor's profit potential, because no risk was effectively transferred. However, the remuneration of the distributor post-restructuring should reflect its functional analysis, including the fact that it does not assume the bad debt risk.

23. Moreover, if the bad debt risk is retroactively reallocated to the associated enterprise, the pre-restructuring remuneration of the distributor might also need to be retroactively adjusted (presumably decreased) as it also should reflect its functional analysis, including the fact that the distributor did not assume the bad debt risk.

24. **We suggest that the example should be deleted**, as it may be confusing and does not add clarity to the Chapter I guidance on risk. If however the example is retained, we suggest that the conclusive sentence should be completed, for instance as follows : *"In such a case there is no risk for the distributor to transfer as part of the business restructuring; both the pre and post restructuring remuneration of the distributor should reflect the fact that it did not assume the bad debt risk."*

Section B.3 Options realistically available to the parties

25. We agree with the guidance at paragraphs 9.27 and 9.31. Paragraph 9.27 sets the principle; while paragraph 9.31 notes that :

The reference to the notion of options realistically available is not intended to create a requirement for taxpayers to document all possible hypothetical options realistically available. Rather, the intention is to provide an indication that, if there is a realistically available option that is clearly more attractive, it should be considered in the analysis of the conditions of the restructuring.

26. The newly added paragraph 9.28 however seems to set a significantly higher compliance burden than 9.27 and 9.31. Paragraph 9.28 reads as follows:

Thus, in applying the arm's length principle, the tax administration should evaluate each transaction as accurately delineated under the guidance in Section D of Chapter I and consider the economically relevant characteristics taken into account by the parties in reaching the conclusion that the restructuring adopted offers a clearly more attractive opportunity to meet commercial objectives than alternative options realistically available (see paragraph 1.38). In making such assessment, it may be necessary or useful to assess the transactions comprising the business restructuring in the context of a broader arrangement of economically related transactions. [emphasis added]

27. This paragraph seems to imply a new documentation requirement of all alternative options realistically available. It would be in contradiction with the guidance at 9.31 and go beyond the guidance at 9.32-9.33. In our view, it is not needed to provide the needed consistency with the Actions 8-10 Final Report.

28. We therefore do not think that this new paragraph would meet the standard set by WP6 "not to revisit the guidance on business restructurings but to focus attention on changes necessary to

address inconsistencies, real or perceived, with the revised chapters, and to remove duplication.” **We accordingly respectfully suggest that this paragraph should be deleted.**

Section B.4 Transfer pricing documentation

29. Changes in the way functions are performed, assets are used and risks are assumed happen on a daily basis in all MNEs. The level of detail prescribed at paragraph 9.33 should not be required for any single change in the intragroup staffing of functions, use of assets or contractual terms. Many of these transactions are simple and capable of being supported with simple comparable studies. Some others may be too small to justify the kind of granular and complex documentation requirements that result from the new Chapter IX guidance.

30. Given the extremely onerous and increasingly complex documentation requirements promoted by the OECD, we think that **the addition of paragraphs 9.32-9.33 should be balanced with the addition of a cross reference to paragraph 32 of the revised Chapter V**, to remind the readers that:

Not all transactions that occur between associated enterprises are sufficiently material to require full documentation in the local file. Tax administrations have an interest in seeing the most important information while at the same time they also have an interest in seeing that MNEs are not so overwhelmed with compliance demands that they fail to consider and document the most important items.

Section C Recognition of the accurately delineated transactions

Business presence

31. Paragraph 9.34 of the Draft is largely based on paragraph 9.163 of the 2010 Guidelines. However, the following sentences were deleted :

MNE groups cannot be forced to have or maintain any particular level of business presence in a country. They are free to act in their own best commercial and economic interests in this regard.

32. We find these two sentences to be especially important in the current context where some tax administrations use the BEPS project to force taxpayers to maintain a level of business presence in a country, despite such presence being irrelevant from a business perspective. We face this issue in the digital industry as well as in all sorts of businesses that rely on distant sales.

33. **We therefore request that these two sentences be reinstated**, as we do not see them as inconsistent or duplicative with the recently approved revisions to the Guidelines.

Not all restructuring transactions may warrant remuneration at arm’s length

34. As noted above in our comments related to Section B.1, not all individual transactions comprising a business restructuring should always be positively compensated at arm’s length. We therefore recommend that **the last sentence of paragraph 9.37 be replaced with a more neutral sentence** which would be more consistent with the rest of the Chapter, such as:

Where a restructuring makes commercial sense for the group as a whole on a pre-tax basis, the arm's length principle should be capable of arriving at a determination of the amounts of compensation, if any, that may be warranted for the post-restructuring arrangement as well as of the amounts of compensation, if any, that may be warranted for the restructuring itself. .

Relevance of tax purpose

35. The 2010 Guidelines contain a section on the relevance of tax purpose at paragraphs 9.181-9.182. Most of it is retained in the Draft, except for the following sentence of 9.182 :

Provided functions, assets and/or risks are actually transferred, it can be commercially rational from an Article 9 perspective for an MNE group to restructure in order to obtain tax savings.

36. This is an important statement, and we do not see it as inconsistent with the Actions 8-10 Final Report or duplicative. **We therefore recommend that it should be retained.** Deleting it would send the wrong message and would not meet the standard set by WP6 for the revision of Chapter IX.

37. In the same vein, paragraph 9.187 of the 2010 Guidelines states that :

That guidance indicates that the tax administration would seek to substitute for the non-recognised transaction an alternative characterisation or structure that comports as closely as possible with the facts of the case, i.e. one that is consistent with the functional changes to the taxpayer's business resulting from the restructuring, comports as closely as possible with the economic substance of the case, and reflects the results that would have derived had the transaction been structured in accordance with the commercial reality of independent parties. For example, where one element of a restructuring arrangement involves the closing down of a factory, any recharacterisation of the restructuring cannot ignore the reality that the factory no longer operates. Similarly, where one element of a restructuring involves the actual relocation of substantive business functions, any recharacterisation of the restructuring cannot ignore the fact that those functions were actually relocated. As another example, where a restructuring arrangement involves a transfer of property between two parties, any non-recognition of the restructuring arrangement would need to reflect that a transfer of such property occurred between the two parties, although it may be appropriate to replace the character of the transfer with an alternative characterisation that comports as closely as possible with the facts of the case (e.g. a purported transfer of all rights in the property might be recharacterised as a mere lease or licence of the property, or vice versa).

38. The thrust of the beginning of the paragraph is now found at paragraph 1.124 of the Actions 8-10 Final Report, which states that :

The structure that for transfer pricing purposes, replaces that actually adopted by the taxpayers should comport as closely as possible with the facts of the actual transaction undertaken whilst achieving a commercially rational expected result that would have enabled the parties to come to a price acceptable to both of them at the time the arrangement was entered into.

39. However, the second part of the paragraph, starting from “*For example, where one element of a restructuring arrangement involves the closing down of a factory*” until the end of the paragraph is deleted. We understand that some slight rewording may be needed in order to be fully consistent with the revised Chapter VI guidance. **We recommend that the useful guidance in the second half of paragraph 9.187 of the 2010 Guidelines be reinstated, subject to the needed revision.** As mentioned above, such guidance is not inconsistent or duplicative, and deleting it would send the wrong message. We suggest the following amended language be reinstated:

~~For example, w~~*Where one element of a restructuring arrangement involves the closing down of a factory, ~~any recharacterisation~~ **the actual delineation** of the restructuring cannot ignore the reality that the factory no longer operates. Similarly, where one element of a restructuring involves the actual relocation of substantive business functions, ~~any recharacterisation~~ **the actual delineation** of the restructuring cannot ignore the fact that those functions were actually relocated. As another example, where a restructuring arrangement involves a transfer of **tangible** property **or an intangible** between two parties, ~~any recharacterisation~~ **the actual delineation** of the restructuring arrangement would need to reflect that a transfer of such **tangible** property **or intangible** occurred between the two parties, although it may be appropriate to replace the character of the transfer with an alternative characterisation that comports as closely as possible with the facts of the case (e.g. a purported transfer of all rights in the property might be recharacterised as a mere lease or licence of the property, or vice versa). [If need be, the following sentence could be added : **Furthermore, the transfer pricing consequences of a transfer of an intangible may depend on the performance by the transferor of functions related to the development, enhancement, maintenance, protection or exploitation of the intangible, see Chapter VI.**]*

40. Finally, the 2010 Guidelines contain 3 examples at paragraphs 9.188-9.194 which provide helpful illustration of the guidance on the recognition of business restructuring transactions. Although such examples may need to be slightly amended in order to be fully consistent with the Actions 8-10 Final Report, we believe that **the examples at paragraphs 9.188-9.194 of the 2010 Guidelines remain broadly consistent with the new standard, are not duplicative, and therefore should not be deleted.**

Section D Reallocation of profit potential as a result of a business restructuring

41. The example after paragraph 9.46 is largely based on the one after 9.72 in the 2010 Guidelines. However, for Scenario 3, Year 3, the profitability rate is 10% in the 2010 TPG, instead of 0% in the Draft.

42. The replacement of the 10% rate with a 0% rate changes the thrust of the example, which is to show that a business which has earned steady high profits in the past may nevertheless face less favorable and uncertain prospects. The replacement of the 10% rate with a 0% rate would suggest that the distributor in the example already faced uncertain profits in the past, thus diminishing the value of the example. **We therefore suggest that the 10% profitability rate be reinstated.**



**Comments to the OECD Discussion Draft on
“Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines”**

On July 4, 2016 the OECD issued its “Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines” in a document for public review. ICC welcomes the opportunity to comment on this review of the conforming changes. While the changes are largely of a clarifying and editorial nature, we wish to point out the following:

Most notably, the amendments work towards aligning Chapter IX with changes that have taken place in other parts of the Transfer Pricing Guidelines. In particular, this refers to the new OECD-guidelines on transfer pricing documentation (Chapter V). In this regard Sec. B.4, 9.32 et seq. clarifies that important business restructurings need to be described in the Master File; similarly, any business restructurings affecting a particular entity must be indicated in that entity’s Local File. Furthermore, the OECD encourages MNE groups to document their decisions and intentions with regard to business restructurings before the transactions occur as well as the evaluation of consequences from that business restructuring. We welcome this guidance as it clarifies the requirements of the new OECD-approach on transfer pricing documentation. At the same time it is explicit that the explanation of decisions and intentions as well as the evaluation of consequences are only recommended, i.e. there is no obligation for such documentation.

Similarly, Chapter IX has been amended to conform to the changes to Chapter VI on intangibles. Thus, Sec. E.2.1., 9.57, now explicitly states that in accordance with the principles laid down in the new Chapter VI, the legal ownership of an intangible does not by itself confer any rights to ultimately retain returns from exploiting that intangible. Rather, referring to Sec. 6.35 et seq., the functions related to the development, enhancement, maintenance, protection, or exploitation should be decisive in assigning returns from an intangible. While these amendments merely trace the earlier changes to Chapter VI, it needs to be noted that this increases the documentation requirements and (in effect) shifts the burden of proof to the taxpayer, i.e. in case of doubt the taxpayer will have to demonstrate which entities perform which functions rather than simply relying on the concept of legal ownership. Furthermore, Sec. E.2.2, 9.62 et seq., are now in line with the new terminology



(“intangibles transferred at a point in time when its valuation is highly uncertain”) and categories (“hard-to-value intangibles”). Additionally, while the blurred definition of hard-to-value intangibles and the use of ex-post information as suggested in Sec. 6.186 may be criticized by themselves, the amendments to Chapter IX merely trace the earlier changes to Chapter VI.

Overall, the content-related changes to Chapter IX seem to be minimal. ICC welcomes the fact that the OECD has kept some important clarifications with regard to the question, when a (taxable) business restructuring is assumed to exist. In particular, the OECD explicitly states that a mere reduction in the profit potential of an entity does not necessarily imply that a (taxable) restructuring has taken place (cf. Sec. D.1, 9.39 et seq.). Similarly, the surrendering of a profit potential with significant uncertainties (including the possibility of losses) and/or of a profit potential that has deteriorated when compared to historical profitability does not necessarily warrant compensation; rather, in comparison it might be preferable to exchange this profit potential for a relatively low but stable rate of profitability (cf. Sec. D.2, 9.46 et seq.).

Further important clarifications that are (still) explicitly contained in Chapter IX refer to the fact that MNEs are free to organize their business operations as they see fit. Tax administrations do not have the right to dictate to an MNE how to design its structure or where to locate its business operations (cf. Sec. C., 9.34). Moreover, business models of MNEs are hardly ever found between independent enterprises; this, however, does not imply that such business models are not arm’s length. Similarly, the reasons for an MNE group to restructure may be found on a group-level rather than on the level of each individual entity (cf. Sec. C., 9.35. 9.37). We welcome the fact that these unequivocal statements have remained in Chapter IX. From our point of view they constitute important aspects to consider when delineating the structure and restructuring of MNEs and serve as a barrier to excessive and unjustified profit adjustments.



The International Chamber of Commerce (ICC) Commission on Taxation

ICC is the world business organization, whose mission is to promote open trade and investment and help business meet the challenges and opportunities of an increasingly integrated world economy.

Founded in 1919, and with interests spanning every sector of private enterprise, ICC's global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.

By e-mail

Tax Treaties, Transfer Pricing and Financial Transactions Division
OECD Centre for Tax Policy and Administration

FROM Mr. J.K.H. van Dam / Mr. W.N.J. Tom - Loyens & Loeff N.V.
REFERENCE 22332883
DATE 16 August 2016
RE Comments Loyens & Loeff on Conforming Amendments to Chapter IX of the
Transfer Pricing Guidelines

Dear Sir / Madam,

In response to the invitation of the OECD to interested parties to review the "Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines" (the "Discussion Draft"), please find in this letter the comments on the Discussion Draft on behalf of Loyens & Loeff N.V.¹ ("Loyens & Loeff", "we" or derivative terms).

Loyens & Loeff appreciate the work done by Working Party No. 6 on the Taxation of Multinational Enterprises, in developing revisions to Chapter IX of the OECD Transfer Pricing Guidelines. We have examined with great interest the proposed revisions of Chapter IX, and we welcome the opportunity to submit comments on the Discussion Draft.

The comments we provide in this letter are our own comments as tax professionals. They do not represent the comments of particular clients.

Summary of our comments

Our comments to the Discussion Draft can be summarized as follows:

1. Chapter IX was added to the OECD Transfer Pricing Guidelines in order to introduce the elements currently included in the amended Chapter I after the implementation of BEPS Actions 8-10. Due to the amendments of Chapter I, Chapter IX could be trimmed down substantially to only specific aspects of business reorganisations. If you consider so we would be happy to provide more specific suggestions.

¹ As a leading firm, Loyens & Loeff is the natural choice for a legal and tax partner if you do business in or from the Netherlands, Belgium, Luxembourg and Switzerland, our home markets. You can count on personal advice from any of our 900 advisers based in one of our offices in the Benelux, Switzerland or in key financial centres around the world. Thanks to our full-service practice, specific sector experience and thorough understanding of the market, our advisers comprehend exactly what you need.

The public limited liability company Loyens & Loeff N.V. is established in Rotterdam and is registered with the Trade Register of the Chamber of Commerce and Industry under number 24370566. Solely Loyens & Loeff N.V. shall operate as contracting agent. All its services shall be governed by its General Terms and Conditions, including, inter alia, a limitation of liability and a nomination of competent jurisdiction. These General Terms and Conditions may be consulted via www.loyensloeff.com. The conditions were deposited with the Registry of the Rotterdam District Court on 1 July 2009 under number 43/2009.

2. The Discussion Draft presents clear consensus on various subjects related to business reorganisations. Further investigation of the proposed texts of the Discussion Draft however makes clear that this consensus is not as clear-cut as it is presented and can be explained in different ways depending on the view the respective party has. We suggest being transparent about the lack of consensus.
3. The Discussion Draft does not seem to take into account that MNEs and the global business environment adjust to more centralised business models irrespective of tax considerations. We suggest publicly accepting the possibility not adapting to change of commercial reality can easily lead to business losing its market position.
4. The Discussion Draft focuses on pre- and post-restructuring analysis, while MNEs tend to gradually implement business restructurings. Legal and fiscal adjustments to these business restructurings tend to follow the commercial implementation of new business models. We suggest including the option to look at a longer “implementation” phase.
5. The Discussion Draft seems to introduce additional transfer pricing documentation obligations for MNEs by introducing ‘recommendations’ and therefore increases the administrative burden of these companies. MNEs will tend to comply with ‘best practice’ and therefore with the recommendations included in the OECD transfer pricing guidelines.
6. The Discussion Draft focuses on the commercial rationality of a business restructuring. It is a fact that commercial rational behaviour looks at after-tax results to distribute to shareholders. The focus of the Discussion Draft on pre-tax profits is in conflict with rational business behaviour. We recommend accepting post-tax results if commercial rational behaviour is the key.
7. The Discussion Draft does not seem to recognize anymore that a pricing arrangement can directly affect the allocation of certain risks between parties. We suggest explicitly accepting “pricing” as means for risk allocation.

These comments will be discussed in more detail in the below paragraphs.

1. Chapter IX was added to the OECD Transfer Pricing Guidelines in order to introduce the elements currently included in the amended Chapter I after the implementation of BEPS Actions 8-10. Due to the amendments of Chapter I, Chapter IX could be trimmed down substantially to only specific aspects of business reorganisations.

Introduction

The Discussion Draft amends Chapter IX as a result of the changes implemented in Chapter I. Below we illustrate that Chapter IX has become less important and less relevant, while the focus on and discussion of the business restructuring itself has not substantially been amended. Overlap between the different Chapters may lead to uncertainty. We therefore suggest to trim down Chapter IX substantially to only aspects of business reorganisations. Below we give examples of areas in which overlap leads to uncertainty.

a. Scope

The scope of Chapter IX was changed as a result of the proposed amendments. Instead of the former definition of a business restructuring, which was defined as the cross border redeployment by a multinational of functions, assets and/or risks, it is now stated that a business restructuring refers to the cross-border reorganisation of the commercial or financial relations between associated enterprises.²

In our view the scope of the Discussion Draft was broadened and it has become less clear what should be characterised as a business restructuring as meant in Chapter IX. A cross-border reorganisation of commercial or financial relations seems to be very broad. To our knowledge there is no reason why these “additional” issues are not sufficiently covered in Chapter I.

b. Deletion of Parts I and IV / references to the revised Chapter I

In addition to broadening the scope, Parts I and IV of Chapter IX are deleted in the Discussion Draft. As a result, more references are made to the guidance provided in Chapter I of the Transfer Pricing Guidelines in the remaining parts of the Discussion Draft.³

Parts I and IV contained guidance on special considerations for risks in the context of business restructurings and the recognition or non-recognition of transactions presented by a taxpayer. The deletion of these Parts and the inclusion of references to Chapter I of the Transfer Pricing Guidelines results in references to more general guidance provided in the Transfer Pricing Guidelines and therefore less specific guidance concerning business restructurings. In this regard, we more specifically refer to the deletion of the current paragraph 9.21 of Chapter IX, which stated

² Paragraph 9.1 Discussion Draft

³ As it is clearly stated that the invitation to review the Discussion Draft should not be used as an opportunity to comment on aspects of the Guidelines which have been changed in the 2015 BEPS Reports, we refer to our previous comments concerning BEPS Actions 8-10 dated 5 February 2015.

that ‘The reference to the notions of “control over risk” and of “financial capacity to assume the risk” is not intended to set a standard under Article 9 of the OECD Model Tax Convention whereby risks would always follow capital or people functions.’ These notions were specifically included in the scope of business restructurings and were not intended to set a standard. As these notions have been included in the revisions of Chapter I, they will be applied on a more general basis.

By deleting Parts I and IV of Chapter IX, the relevance of Chapter IX seems to have decreased, as Chapter IX now only contains guidance on the arm’s length compensation for the restructuring itself and the remuneration of post-restructuring controlled transactions.

c. Delineation of transactions

The reference to Chapter I also becomes more clear in the amendments made in Part I of the Discussion Draft. Business restructurings should be delineated in the transactions that comprise the business restructuring.⁴ In the guidance provided in Part B, reference is made to Section D.1 of Chapter I very frequently. Due to the frequent references to the guidance of Chapter I the guidance provided in Chapter IX becomes in fact very general and therefore the purpose of Chapter IX seems to be less important.

Furthermore, by focussing on the delineation of the (individual) transactions comprising a business restructuring, the (purpose of the) business restructuring as a whole seems to have become less important or even in conflict with the delineation of each of the transactions. Minor references are made to this business restructuring as a whole by stating that it may be necessary or useful to assess the transactions comprising the business restructuring in the context of a broader arrangement of economically related transactions.⁵ In our view, the Discussion Draft focusses too frequently on the separate transactions and minimal reference is made to the background of MNE group restructurings.

d. Functions, assets and/or risks

Some amendments included in the Discussion Draft, which seem to be amendments of minor detail, can in fact be related to the deletion of the current paragraph 9.21. In multiple paragraphs the wording ‘functions, assets and/or risks’ are now amended to ‘functions, assets and risks’.⁶ Based on this amendment, Chapter IX seems to conclude that a change in functions, assets or risks following a business restructuring always means that this change is interrelated to a change in functions, assets and risks combined. In our view, not all business restructurings will result in changes in combined functions, assets and risks, but may also be limited solely to functions, assets or risks.

⁴ Paragraph 9.10 Discussion Draft

⁵ Paragraph 9.28 and 9.36 Discussion Draft

⁶ Paragraphs 9.15 and 9.71 Discussion Draft

2. The Discussion Draft presents clear consensus on various subjects related to business reorganisations. Further investigation of the proposed texts of the Discussion Draft however makes clear that this consensus is not as clear-cut as it is presented and can be explained in different ways depending on the view the respective party has.

Introduction

The aim of the transfer pricing analysis according to the Discussion Draft is to determine whether conditions have been made or imposed in transactions comprising a business restructuring that differ from those that would be made or imposed between independent enterprises; and if so, to determine the profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, and include them in the profits of that enterprise and tax them accordingly. Before these amendments, Chapter IX was more nuanced, stating that these profits may be included in the profits of that enterprise and taxed accordingly. The Discussion Draft seems to prescribe that the guidance provided in Chapter IX concerning business restructurings also provides a clear basis to include and tax additional profits, which is in our view often not the case.

The Discussion Draft seems to introduce clear consensus and guidance on various subjects related to business reorganisations. The review of the Discussion Draft however makes clear that this consensus and guidance is not as clear-cut as it is presented and can be explained in different ways depending on the view the respective party has. We suggest being transparent about the lack of consensus.

Below we will provide examples that makes clear that this consensus and guidance is not as clear-cut as it is presented.

a. Contractual agreements

The Discussion Draft seems to lower the importance of and attention towards contractual arrangements. The Discussion Draft states that *'agreements provide the starting point for delineating transactions comprising the business restructurings between the MNEs involved.'* The contractual terms may describe the roles, responsibilities and rights of the restructured entity under the pre-restructuring arrangement (including in relevant circumstances those existing under contract and commercial law) and of the manner and extent to which those rights and obligations change as a result of the restructuring. *'However, where no written terms exist, or where the facts of the case, including the conduct of the parties, differ materially from the written terms of any agreement between them or supplement these written terms, the actual transactions comprising the business restructuring must be deduced from the facts as established, including the conduct of the parties.'*⁷

⁷ Paragraph 9.17 Discussion Draft

Furthermore, *‘the analysis focuses on what the parties actually do and the capabilities, as well as the type and nature of assets used or contributed by the parties in a pre-restructuring and post-restructuring scenario.’*⁸ In addition, in certain examples guidance is provided in which risks are allocated to a certain party, *‘notwithstanding contractual terms’*.⁹

With respect to indemnification clauses, it is explicitly stated that *‘when the facts of the case differ from the written terms of the agreement between the parties or when no written terms exist, the absence or existence (and its terms) of an indemnification clause should be deduced from the conduct of the parties’*.¹⁰ This differs from the starting point for reviewing indemnification clauses as included in the current Chapter IX, in which it is stated that the question can arise whether the terms of the contract between associated enterprises are arm’s length.¹¹

Also in relation to business restructurings comprising intangibles, Chapter IX seems to conclude, with reference to the amended Chapter VI, that contractual arrangements or legal ownership are less relevant. Chapter IX focuses in its explanations on the transfer of legal ownership of intangibles, implicating that business restructurings often focus on the sole transfer of legal ownership without the relating transfer of functions or risks has taken place.¹² However, the transfer of legal ownership without the relating transfer of functions or risks also occurs between independent parties.

Based on the above, the detailed text of the Discussion Draft is less clear-cut than presented. The Discussion Draft in principle seems to prescribe the use of contractual arrangements as a starting point in reviewing transactions. However, the Discussion Draft often lowers the importance of the contractual arrangements in business restructurings and focuses on the so called ‘facts of the case’ and the ‘actual conduct of the parties’. Therefore, contrary to the starting point, the Discussion Draft’s guidance seems to conclude that contractual arrangements are in fact not leading and are used by MNEs to present business restructurings in another way than they are actually intended. In our view, the focus should in principle lie with contractual arrangements and tax authorities should only in extraordinary cases deny these contractual terms, as, amongst others, the ‘facts of the case’ and the ‘actual conduct of the parties’ are vague concepts.

b. Reference to Chapter I in examples

The examples included in the Discussion Draft frequently refer to the analysis that should be performed on the basis of the guidance provided in Chapter I as well. Following this reference, it is for example stated that “this analysis may establish” or “the analysis described establishes that”, while the actual analysis of the facts is lacking.¹³ The examples included in the Discussion Draft

⁸ Paragraph 9.18 Discussion Draft

⁹ Paragraph 9.20, paragraph 9.94 Discussion Draft, paragraph 9.118 Chapter IX

¹⁰ Paragraph 9.82 Discussion Draft

¹¹ Paragraph 9.106 Chapter IX

¹² Paragraphs 9.57-9.61 Discussion Draft

¹³ For example, paragraphs 9.20, 9.21 and 9.25 Discussion Draft

describe the potential consequences of these Chapter I based analyses. However, without further substantiation of the conclusions drawn in these analyses, the examples in principle do not provide clear guidance and can easily be used to fight transactions that also occur between unrelated parties.

c. Text amendments which result in less clear guidance

Certain amendments of Chapter IX result in texts that do not provide clear guidance. A few examples are provided below.

With regard to the guidance provided for outsourcing, it is now stated that *'independent parties implementing this type of outsourcing arrangement ~~and do~~ may not necessarily require explicit compensation from the transferee if, for example, where the anticipated ~~cost savings~~ benefits for the transferor are greater than its restructuring costs.'*¹⁴ By changing the wording the guidance becomes less clear.

Another example is provided in the following text addition; *'In practice, the investment by an associated enterprise in a manufacturing plant where that enterprise is wholly dependent on another associated enterprise for the capability to generate returns is likely to require careful scrutiny in relation to the identification of risks and how those risks are controlled.'*¹⁵ Based on this text, one should carefully review the situation where an associated enterprise is wholly dependent on another associated enterprise for the capability to generate returns. It is however not clear at all when this would be the case or what the result will be. It also occurs between unrelated parties.

An amendment of the following guidance also results in less clear wording; *'The restructured distributor may be able to negotiate an arrangement that does not contain a trial period or other similar unfavourable conditions, while such a trial period or conditions may be common for new distributors'* is changed into *'In such a situation, the restructured distributor would not be in the same position as a newly established distributor'*.¹⁶ The amended text is very general.

d. The introduction of generalisations and suggestive examples

The Discussion Draft uses general observations (e.g. 'generally', or 'typically') and subsequently suggests to apply these observations under all circumstances. An example is provided in paragraph 9.121 in which it is stated that *'typically, as part of the restructuring the entity may have been purportedly stripped of intangibles or risk, but after the restructuring it continues to carry out some or all of the functions previously performed.'* These text amendments suggests that business restructurings are always used to purportedly strip an entity of intangibles or risk in order to shift profits, while MNEs normally perform business restructurings for bona fide commercial reasons like

¹⁴ Paragraph 9.74 Discussion Draft

¹⁵ Paragraph 9.90 Discussion Draft

¹⁶ Paragraph 9.102 Discussion Draft

obtaining benefits from centralisation of risks or intangibles although the “local” people will often not immediately be fired.

By including suggestive examples¹⁷, the Discussion Draft suggests that these examples demonstrate that the tax effects should be similar in business restructurings with bona fide commercial objectives.

3. The Discussion Draft does not seem to take into account that MNEs and the global business environment adjust to more centralised business models irrespective of tax considerations.

The Discussion Draft explains that businesses have indicated that multinational businesses have reorganised their structures to provide more centralised control and management of manufacturing, research and distribution functions.¹⁸ It is also stated that MNE groups are free to organise their business operations as they see fit and that tax administrations do not have the right to dictate the MNE how to design its structure of where to locate its business operations.¹⁹ However, the explicit recognition that the implementation of integrated business models and the development of global organisations are performed for bona fide commercial reasons was removed.²⁰ Furthermore in the previous text the difficulty of reasoning in the arm’s length theoretical environment was highlighted, as the arm’s length principle treats members of an MNE group as if they were independent parties. Instead of a difficulty the OECD now characterises this as a complexity.²¹

As discussed in comment 1, by focussing on the delineation of the (individual) transactions comprising a business restructuring, the (purpose of the) business restructuring as a whole seems to have become less important.

In addition, based on the wording of the Discussion Draft, in assessing the options realistically available to the participating companies it should be assessed whether the (specific) transaction offers a clearly more attractive opportunity to meet their commercial objective.²² We wonder what the purpose is of adding the wording concerning the commercial objective of the company, as this is a rather vague concept. Moreover, by focussing on the commercial objective of the company, the business restructuring of the group as a whole may at first sight have no direct impact anymore on the reasons for an individual MNE group company to participate in the business restructuring, as all transactions comprising a business restructuring should add to the commercial objective of each MNE group company individually.

¹⁷ For example, paragraphs 9.122-124 Discussion Draft

¹⁸ Paragraph 9.24 Discussion Draft

¹⁹ Paragraph 9.34 Discussion Draft

²⁰ Paragraph 9.6 Discussion Draft

²¹ Paragraph 9.6 Discussion Draft

²² Paragraph 9.27 Discussion Draft

The risk exists that the commercial objective of the MNE group as a whole, which will in the end also benefit the individual group companies, is not taken into account when tax authorities are assessing business restructurings from a (corporate income) tax perspective. This may also be the case when different ‘status quo positions’ are used in assessing the options realistically available. It may be in the interest of an individual group company to participate in a business restructuring, as for example not participating will result in a sharp decline of sales because the group will find an alternative provider (potentially a third party without the group company having any possibility to stop such decision) or less beneficial procurement conditions for the individual group company. This may contradict with the statement that MNE groups are free to organise their business operations as they see fit and that tax administrations do not have the right to dictate the MNE how to design its structure of where to locate its business operations.²³

4. The Discussion Draft focuses on pre- and post-restructuring analysis, while MNEs tend to gradually implement business restructurings. Legal and fiscal adjustments to these business restructurings tend to follow the commercial implementation of new business models.

Based on the Discussion Draft, the accurate delineation of the transactions comprising a business restructuring requires performing a functional analysis that seeks to identify the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed before and after the restructuring by the parties involved.²⁴

In this regard, we want to emphasize that MNEs tend to gradually implement business restructurings. The legal and fiscal implementation of these business restructurings tend to follow the gradual commercial implementation of new business models some time later. Due to the gradual implementation of business models, the pre- and post-restructuring comparison may be very difficult to perform. A clear marking point to divide the pre- and post-restructuring situations is in these type of business restructurings hard to apply and may therefore result in discussions between tax authorities and taxpayers.

5. The Discussion Draft seems to introduce additional transfer pricing documentation obligations for MNEs by introducing ‘recommendations’ and therefore increases the administrative burden of these companies. MNEs will tend to comply with ‘best practice’ and therefore with the recommendations included in the OECD transfer pricing guidelines.

²³ Paragraph 9.34 Discussion Draft

²⁴ Paragraph 9.18 Discussion Draft

The amendments included in the Discussion Draft may lead to additional transfer pricing documentation obligations for taxpayers.

First of all, as a result of the amendments Chapter IX still states that it is not intended to create a requirement for taxpayers to document all possible hypothetical options realistically available. However, the wording that ‘no requirement for an exhaustive search of all possible relevant sources of information’ has been deleted.²⁵ By deleting this sentence, we assume that no different approach concerning the requirements for taxpayers to document the options realistically available is prescribed compared with the previous text.

In addition, the Discussion Draft recommends MNE groups to document their decisions and intentions regarding business restructurings (next to the obligations for these groups in their master file and local files), especially as regards their decisions to assume or transfer significant risks, and to document the evaluation of the consequences on profit potential or significant risk allocations resulting from the restructuring.²⁶ In our view, this creates an additional implicit burden on MNE groups concerning their documentation obligations, as a recommendation will certainly result in local tax authorities requesting such documentation and MNEs will tend to comply with ‘best practice’.

6. The Discussion Draft focuses on the commercial rationality of a business restructuring. It is a fact that commercial rational behaviour looks at after-tax results to distribute to shareholders. The focus of the Discussion Draft on pre-tax profits is in conflict with rational business behaviour.

In the Discussion Draft a statement is included describing that *‘the fact that a MNE group as a whole is left worse off on a pre-tax basis may be a relevant pointer in determining the commercial rationality of the restructuring’*.²⁷ We do not agree with this statement, as a rationally behaving market party will only base its decision making on a post-tax basis rather than on a pre-tax basis.

This can be illustrated as follows. A company performing high risk activities will expect higher returns than a company performing low risk activities. In general, a trade-off will exist between risk and return. A rationally behaving market party will review this risk-return trade-off on a post-tax basis. Under the assumption that the “pricing” correctly reflects the risks, after a certain period the “overall returns” of both the high-risk scenario and the low-risk scenario will be almost similar on a pre-tax basis. Limitations on loss carry forwards will impact the risk-return trade-off, as the company performing high risk activities may be limited in compensating its losses with its profits for corporate income tax purposes. The average tax costs for this high risk company will therefore increase, which will impact the post-tax return of the investors. As a result, an investor may choose to invest

²⁵ Paragraph 9.33 Discussion Draft

²⁶ Paragraph 9.33 Discussion Draft

²⁷ Paragraph 9.38 Discussion Draft

in the company performing low risk activities, as on a post-tax basis the risk-return trade-off will be more beneficial.

7. The Discussion Draft does not seem to recognize anymore that a pricing arrangement can directly affect the allocation of certain risks between parties. We suggest explicitly accepting “pricing” as means for risk allocation.

The wording currently included in paragraphs 9.44-46 concerning the relationship between the choice of a particular transfer pricing method and the level of risk left with the entity that is remunerated using that method is deleted due to the deletion of Part I of Chapter IX. In the Discussion Draft wording relating to this question is added to paragraph 9.108. The Discussion Draft states that the form of remuneration cannot dictate inappropriate risk allocations and that the risk allocation should be determined on the basis of the guidance provided in Chapter I. The selection of the most appropriate transfer pricing method should be dictated by the allocation of risks.

In our view, the wording of the current paragraphs 9.44-9.46 is more nuanced, as it first distinguishes between pricing arrangements and transfer pricing methods. In this regard, it is amongst others recognized in those paragraphs that with respect to the pricing arrangement according to which prices and other financial conditions of a transaction are contractually set, the terms to which a party to a transaction is compensated cannot be ignored in evaluating the risk borne by that party. In effect, the pricing arrangement can directly affect the allocation of certain risks between the parties and can in some cases create a low risk environment. Unfortunately these explanations have been deleted in the Discussion Draft.

The relation between the pricing arrangement and the allocation of risks can be illustrated as follows. A consumer buying a car from a renowned garage will pay a different price than a consumer buying a similar car from a private person. This difference in price also represents the risk the consumer incurs when buying the car from the private person. As he is paying a (substantial) lower price to the private person, he is aware that the risk exists that the car has certain defects which may appear within a short timeframe when buying the car from the private person.

Respectfully submitted,

Yours sincerely,
Loyens & Loeff N.V.

Mr. J.K.H. van Dam / Mr. W.N.J. Tom

By e-mail

Tax Treaties, Transfer Pricing and Financial Transactions Division
OECD Centre for Tax Policy and Administration

FROM Mr. J.K.H. van Dam / Mr. W.N.J. Tom - Loyens & Loeff N.V.
REFERENCE 22354750
DATE 19 August 2016
RE Addition to comments Loyens & Loeff on Conforming Amendments to Chapter IX
of the Transfer Pricing Guidelines

Dear Sir / Madam,

In addition to our comments on Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines as submitted on 16 August 2016, please find below one additional comment.

8. Growing number of functionally centralized businesses that have geographically spread management

In this additional comment we want to point out that an increasing number of MNEs operate functionally centralized but independent of physical location. Due to videoconferencing, paperless offices, application of English as common language within a company and obligations to travel regularly, the “physical” location is increasingly irrelevant for management functions performed within MNEs. The “best” person in a region, or potentially even in the world, is appointed for the management function. No business reasons require the person to relocate to another country. Therefore, these functions are subsequently performed by various persons in multiple locations around the region, or the world. The people performing these functions often have decision-making responsibilities.

In practice, we notice that tax authorities and taxpayers enter into discussions with regard to these situations. Applying profit splits and potential exit tax charges are generally considered not to be appropriate in this context of frequently changing locations where functions are performed.

We would suggest to report on these situations in Chapter IX and confirm that performing functions on frequently changing locations is not qualified as a business reorganisation.

Respectfully submitted,

Yours sincerely,
Loyens & Loeff N.V.

Mr. J.K.H. van Dam / Mr. W.N.J. Tom

Conforming amendments to Chapter IX of the OECD TPG Comments by NERA Economic Consulting¹

August 16, 2016

to TransferPricing@oecd.org

to the Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA

Dear Sir, Dear Madam,

In the context of the BEPS Action Plan, Working Party No. 6 of the OECD has released on July 4, 2016, a document for public review (the “Draft”) outlining Conforming amendments to Chapter IX of the OECD Transfer Pricing Guidelines (“TPG”). The Draft aims at factoring in, at the level of Chapter IX, the changes - approved on May 23, 2016 by the Council- brought by the 2015 Base Erosion and Profit Shifting Reports to the Chapters I, VI and other Chapters of the TPG. These changes stem in particular from the 2015 BEPS Report on Actions 8-10, “Aligning Transfer Pricing Outcomes with Value Creation”.

We thank you for the opportunity to provide comments on this document.

1. Introduction

Chapter IX has a particular place in the TPG and in the heart of transfer pricing experts. Prior to the 2015 Action 8-10 BEPS Deliverable, it was in Chapter IX that a number of key concepts were first pioneered². One can cite: (i) the framework for risk, (ii) the concept of Options Realistically Available (ORAs), (iii) the primacy of conduct of the parties over legal formalism, (iv) the need for holistic view of transactions and business relationships, etc. The new version of Chapters I and VI have now built upon these concepts and rightfully expanded their use to non-business-restructuring situations.

Consequently, we believe a conforming review of Chapter IX to be timely and legitimate. As such, we would like to offer the following comments.

¹ These comments represent independent views of the authors and do not necessarily reflect the views of NERA Economic Consulting.

² To various extents.

2. We believe most of the proposed conforming amendments to be justified...

As a general comment, we believe the general work of simplification and rationalization by the OECD to be largely positive. In particular:

- The “special considerations for risks” in former Part I are now largely embedded within Chapter I and VI. As such, a specific consideration in Chapter IX is no longer required.
- The replacement of the former Part IV, discussing “transaction recognition”, by the new section B.1. on delineation does add clarity and consistency to the Transfer Pricing Guidelines.

Of course, one could have hoped the OECD to be even bolder in its changes.

Business restructurings can take many shapes, but the common line is to understand what drives the restructuring and what changes it comprises in roles and responsibilities for the entities involved in the (continued) context of joint value creation. This is the subject of the examination (see also 9.19) of the facts of the restructuring, which should lead to identifying the business case for it. The identification of the value created by the restructuring is a holistic exercise: it is the starting point for the analyses of the treatment of the parties involved under the arm’s length principle.

By focusing on clarifying the principles at stake (in particular: the arm’s length principle also fully applying to business restructurings), we believe that Chapter IX could probably have been reduced to a fraction of its current size. The apology at the end of par 9.6 is illustrative in this respect: “qui s’excuse, s’accuse”?

By the same token, we believe that the wide use of examples (pars 9.15, 9.19, 9.21, 9.65, 9.70 etc.) risks to add little and rather come forward as “kicking in open doors”.

3. ... with a few – but very important – exceptions...

3.1. Administrative formalism

The OECD does good work at outlining how legal aspects, of different types, may have an impact on the analysis of a right to indemnification at arm’s length. In this regard, we find the discussion in section F.2 on “Whether the existence or absence of an indemnification clause or similar provisions (as well as the terms of such a clause where it exists) under the terms of the arrangement, as accurately delineated, is arm’s length.” to be of importance.

Yet, we believe that the OECD should make it clearer that in certain circumstances, the conduct of the parties in terms of pure administrative formalism – such as the way to arrange the contracts, the way to terminate them - may not be relevant in the analysis.

Typically, a failure by a party, in an intercompany context, to comply with the applicable termination notice provisions may not always be relevant. That may be the case when for example (i) the termination was not formally notified in due time, as per the intercompany context, but, at the same time (ii) the actual business conduct of the parties show that both parties had in fact been notified in due time of such termination.

The OECD had managed give the consideration of legal arrangements in the context of intangible transactions their right place, by acknowledging that, in certain circumstances, the conduct of parties may override intercompany legal arrangements. Similarly, the OECD should have been bolder in introducing more clearly some level of flexibility in business restructuring contexts, as regards the way to take into account legal arrangements and the parties' formal compliance with them.

3.2. Identifying the parties to the transaction

The new section F.3 provides some very helpful clarification on how to determine which party should ultimately bear the restructuring costs, stating the principle that the indemnification should be paid by the party ultimately benefiting from the restructuring.³

This clarification is welcome, but leaves unaddressed many questions on the identification of the parties to the transaction.

The Draft re-emphasizes that Business Restructurings fully qualify as intercompany transactions⁴ 4. Transactions are bilateral dealings. Similarly, the OECD MTC and article 9 are, in essence, bilateral.

Yet, we believe that one of the most unique features of Business Restructuring transactions is that parties may not always be easily evidenced.⁵ This triggers very concrete issues when dealing with Business Restructuring.

³ §9.97: "In cases where the benefits arising from the restructuring accrue to another party in the MNE group, then that other party may bear the costs of indemnification, either directly or indirectly."

⁴ S See §9.9: "*the arm's length principle and these Guidelines do not and should not apply differently to restructurings or post-restructuring transactions than to transactions that were structured as such from the beginning*".

⁵ In particular when these transactions only exist from a transfer pricing perspective with no accounting entry or legal existence (e.g. application of Group's instructions).

One may for instance take the application of the ORA framework in a Business restructuring: the bargaining power of a given party will be vastly different if we assume it to be, for the application of the arm's length principle, in a bilateral or in a multilateral relationship between parties involved in a restructuring⁶.

Should the F.3. approach be considered in this regard? We believe that at this stage, many field auditors would disregard such an approach in practice, ignoring further guidance from the OECD.

More generally, we find in the Draft a too direct focus on analysis at the level of transactions that tend to be seen as bilateral phenomena, while there usually is so much more involved in restructurings. It is indicative that the proposed text continuously (starting with par 9.10) speaks of "transactions that comprise a business restructuring". In reality, it is the other way around: what we should do is take the Business Restructuring (and its business case) as starting point and identify the transactions that the Business Restructuring comprises.

4. ... but to fail to take full advantage of the concept of relational transfer pricing

In its original form, Chapter IX lacked a meaningful component on "value" and "value creation". Although Chapters I and VI expand on this, we find that proposed Chapter IX still treats "value" as a poor relation.

We think that the OECD fails to take full advantage of the concept of relational transfer pricing, outlined in the new Chapters I and VI.

One other⁷ largely unique feature of Business Restructurings is that to be properly analyzed under the arm's length principle, they need to be analyzed over the full length of the relationship between parties.

⁶ For instance, the outcome of an arm's length negotiation shall be vastly different if the party to the business restructuring in country A is, for instance :

- The legal entity, on a stand-alone basis,
- The legal entity, with all its subsidiaries, or
- The legal entity, together with all the other companies in the group, to the exception of its counterpart in the transaction under review.

⁷ By reference to the fact that parties to the transaction may be difficult to identify see 3.3

A number of Business Restructuring situations may give the false impression that they give rise to a compensation right or a transfer of intangible only because the “Group” is seemingly taking away a profit potential which was there in the first place only because of the Group’s local involvement.

The right framework to analyze Business Restructurings under the arm’s length principle should ultimately consider the balance of the value contribution of each party over the longer term, so that the terms of the business restructuring allocate to each of the parties a return commensurate with their total long term contribution to the joint value creation, as would happen at arm’s length between unrelated parties.

The concentration in the proposed Chapter IX on transactions as a means to evaluate the arm’s length character of the resulting consequences for individual parties to a business restructuring tends to favour the use of generalized characterizations of roles and responsibilities that do not necessarily capture the essentials and to leave insufficient attention for the business case as a whole. In today’s business environment, changes are such that they trigger new roles and new ways of performing existing roles as a consequence of the fact that, in the “digital economy”, location has become of relative importance. A group company that operates its enterprise in a certain jurisdiction and as a consequence of restructuring now starts to act simultaneously as part of the enterprise of a related company may also encounter permanent establishment issues. Issues like that can only be dealt with by way of an analysis of value involved for the business as a whole as well as for the individual entities involved. This can only be grounded in a dynamic value chain analysis. The new Chapter IX should be more explicit in this respect.

Pim Fris, Guillaume Madelpuech
Paris

Appendix A. Additional specific textual suggestions

9.1: Suggest to delete: “cross-border”.

9.2: Suggest to add: Business restructurings “can take many shapes, but in TP terms” may often...

9.9, 2nd line: Suggest to replace “or” by “and”.

9.10, 5th and 8th line: Suggest to replace “that comprise the business restructuring” by “that the business restructuring comprises”.

9.11, 2nd line: Same as for 9.10.

9.13, 4th line: Same as for 9.10.

9.17: Same as for 9.10.

9.19: Suggest to add: ...context of business “and therefore of also of” restructurings...

9.19 (2): 8th line speaks of “examination”, and 10th line of “such analysis”; please note that an “examination” concerns the facts and the business case of a restructuring, and is followed by an “analysis” of the consequences.

9.27: last line: Suggest to add ...comparability analysis “(that follows and complements the examination of facts)”, to understand....

9.35, 1st line: Suggest to replace “lead MNE groups to implement” by “are the consequence of MNE groups implementing”

9.37, 2nd line: Suggest to add ... separate entities “(although in their relations as they are)” rather than....

9.42, 3rd line: Suggest to add ...parties, “including the consequences for roles and responsibilities in joint value creation”, what...

9.54, 3rd line: Same as for 9.10.

9.94, 12th line: Same as for 9.10.

9.108, 1st sentence: Suggested wording: “Design and implementation of a TP system”



Mr Jefferson VanderWolk
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By email to: TransferPricing@oecd.org

16 August 2016

Dear Mr VanderWolk

Discussion Draft: Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines

PricewaterhouseCoopers International Limited on behalf of its network of member firms (PwC) welcomes the opportunity to comment on the conforming changes to Chapter IX of the OECD Transfer Pricing Guidelines, *Transfer Pricing Aspects of Business Restructurings*.

We recognise the conforming nature of most of the changes proposed by Working Party No. 6 and commend them on the broad approach. However, given the aims to reflect the changes in the rest of the Guidelines resulting from the October 2015 BEPS Reports and, in particular, to reflect the new risk and recognition approach in revised Chapter I, we believe some of the changes are unnecessary or even counterproductive.

General concepts

1. There are a number of instances in which the revised wording suggests the need for, or likelihood of, a transfer pricing compensation for any restructuring. We submit that the premise should be that on an arm's length basis an objective view needs to be taken of the related party transactions involved and this should be reflected throughout the Guidelines.
2. We have a concern about interaction between new Chapter IX and new Chapter VII on low-value intra-group services. It may be that some services really don't have profit potential and that shifting those activities should not be subject to the restructuring guidance or, perhaps more accurately, the guidance should clarify that the profit potential may be minimal for those situations. It would be helpful if Chapter IX provided cross-references to Chapter VII as well as additional guidance on the treatment of low-value services under Chapter IX.

Unhelpful deletions

3. In paragraph 9.34 of the discussion draft, apparently based on paragraph 9.163 of the current Guidelines, the following sentences have been deleted: “MNE groups cannot be forced to have or maintain any particular level of business presence in a country. They are free to act in their own best commercial and economic interests in this regard.” Those reflected a generally held international standard which is being weakened as a result of more countries requiring local operations as part of unilateral provisions and could helpfully be retained.
4. Revised wording in paragraph 9.38, apparently based on paragraphs 9.181 and 9.182 of the current Guidelines, omits the sentence “Provided functions, assets and risks are actually transferred, it can be commercially rational from an Article 9 perspective for an MNE group to restructure in order to obtain tax savings.” The clarification in this wording is generally considered helpful, while its removal would be a retrograde step. It is though welcome that it is intended to retain the statement that makes it clear that domestic anti-abuse rules are not within the scope of Chapter IX, so that domestic rules that require a non-tax business purpose for a restructuring are not implicated by the guidance.
5. In the current Guidelines there is an illustration (Example C in paragraph 9.193) which helps create certainty regarding the legitimacy of transactions that are rational on a post-tax rather than pre-tax basis and it would be helpful if the example would be retained. This is even more so because of the insertion of specific reference in new paragraph 9.37 to restructurings that make commercial sense on a pre-tax basis. A wide number of factors would generally be considered in such transactions, including but not limited to both pre-tax income and post-tax income.

Confusing amended wording

6. Revised paragraph 9.2 reads: “Business restructuring may often involve the centralisation of intangibles, risk, or functions with the profit potential attached to them. They may typically consist of ... The concentration of functions in a regional or central entity, with a corresponding reduction in scope or scale of functions carried out locally; examples may include procurement, sales support, supply chain logistics.” The language on functions is not in the current version of Chapter IX and we suggest it be changed as it might otherwise be taken out of context to support some form of exit taxation regime whenever production decreases in one country and increases in another.
7. In paragraph 9.65, the additions and, in particular, the reference to “legal ownership” of local marketing intangibles raises questions regarding the OECD’s “something of value” approach to defining an intangible asset. Clarification of this wording would improve consistency of the Guidelines.



We look forward to discussing any questions you have on the points we raise above or on other specific matters raised by respondents to the Discussion Draft.

Yours faithfully,

A handwritten signature in black ink, appearing to be 'Stef'.

Stef van Weeghel, Global Tax Policy Leader

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Brussels, 16 August 2016

Subject: Public review comments on OECD report “Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines”, dated 4 July 2016

Sent by e-mail to TransferPricing@oecd.org

Dear Mr. VanderWolk,

We are pleased to have been invited to review the document “Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines”, published by the OECD on 4 July 2016 (hereafter, “the Document”), and provide you with our comments. We first start with some general comments, followed by a more detailed discussion on some selected topics.

1. General comments

Overall, in view of the purpose of the review – i.e. to establish that real or perceived inconsistencies with the revised parts of the Guidelines have been appropriately addressed, and duplication appropriately removed – we can confirm that overall the OECD **largely succeeded with the Document to update Chapter IX in line with the earlier BEPS changes and to remove duplication.**

However, – without having the intent to comment on aspects of the Guidelines which have been changed in 2015 BEPS Reports, and without having the intent to comment on the guidance on business restructurings which is not affected by the conforming changes – we wish to point out certain aspects that do give us **some important concerns.**

Most notably, in respect of the following selected two most salient topics we do feel that the Document adds additional guidance beyond the arm's length principle (as per the referred to revised parts of the Guidelines) and/or adds unnecessary complexity and opaqueness to the appropriate application of that arm's length principle:

- **The requirement of pre-tax arm's length test goes beyond the requirements of the (revised) parts of the Guidelines, and is not in line with the general arm's length principle; and**
- **The presumption that any business restructuring, which moreover now has been arguably more broadly (and in our view wrongly) defined, would necessitate an arm's length compensation**

Here below, we will provide a more detailed discussion on the here above selected two most salient topics.

2. More detailed discussion (selected topics)

A. On the requirement of having a pre-tax arm's length test goes beyond the requirements of the (revised) parts of the Guidelines, and is not in line with the general arm's length principle [real inconsistency]

Although referenced to already in the revised Guidelines (paragraph 1.122), the Document emphasizes in paragraphs 9.37 and 9.38 of the Document that commercial sense would need to be tested on a pre-tax basis. Although we are not to comment on the revised Guidelines, in view of business restructurings in particular emphasizing this notion – which in our view intrinsically violates the arm's length principle, since third parties would come to a conclusion on commercial rationale on a different basis as well (if not predominantly) to invest or divest – leads to a requirement beyond the arm's length principle when it is coupled to the expectation (read: presumption) that an appropriate transfer price would generally be available for each individual member participating in it as paragraph 9.37.

Indeed, we have the strong conviction that the arm's length principle is the prevailing standard, and this guidance provides for a real inconsistency – for the avoidance of doubt, already in view of paragraph 1.122, but most definitely in paragraph 9.38. Namely, in arm's length conditions third parties will assess their eligibility on compensation, and feasibility thereof, also (and in our experience in third party investment valuation work we perform) on (and predominantly on) other grounds, including (post-tax) cash flow differential, and many other considerations.

Therefore, limiting the use of arm's length testing of whether commercial rationale exists (on either group or individual level) and compensation for the business restructuring is required depends on many factors and not only, if at all, on a simple pre-tax comparison, most in particular in respect of business restructurings.

We suggest erasing the notion or apparent obligation to test the commercial rationale solely on a pre-tax basis, and acknowledge that there are many factors that are potentially to be taken into account.

B. On the presumption that any business restructuring, which moreover now has been arguably more broadly (and in our view wrongly) defined, would necessitate an arm's length compensation

Again with reference to paragraph 9.37, we want to highlight that it contains a presumption that any business restructuring would entail generally (or at least it feeds the expectation that) an appropriate transfer price would include a compensation payment for the restructuring itself. We find this most problematic in the light of the apparent broadening of the business restructuring definition as contained in the new paragraphs 9.1 and 9.2.

In contrast with the existing paragraph 9.1 business restructurings are defined as reorganisations of the commercial or financial relations between associated enterprises, whereas in the existing guidance business restructurings were limited to a redeployment of functions, assets and/or risks.

Whereas redeployment has generally a more narrow meaning (the process of using resources for a different purpose than originally intended) than reorganization (a change in the way that something is done, in order to improve it generally), in view of the subject matter – whether commercial or financial relations or functions, assets and/or risks – a semantical problem in our view exists that can have adverse technical and practical consequences, and which moreover is not consistent with the revised Guidelines in our reading.

Namely, in view of the revised Guidelines, we understand that the identification of the relevant commercial and financial relations between associated enterprises is a consequence of the full context in which the associated entities (paragraph 1.34), whereas the functions, risks and/or assets being merely part of that context (paragraph 1.36). The key difference in our view is that arguably an MNE group and its associated enterprises may have a relatively large discretion over the purpose of how functions, assets and/or risks are to be organized, and potentially redeployed), they do not have an equivalent discretion over the other factors defining the relevant commercial or financial relations such as the economic circumstances and business strategies pursued. The point to be taken in this respect in our view is that one can have a 'reorganisation of financial or commercial relations' without the necessity to 'redeploy functions, risks and/or assets'.

As such, we do find intent and control of the business restructuring a relevant criteria, and suggest to keep the existing definition of business restructurings, whereas we do agree that financial and commercial relations, once a business restructuring can be recognized, are to be factored in (as controlled transactions are a consequence of the defining features of the commercial or financial relations that can be identified, and that are potentially different pre-vs. post-restructuring), but as factors to understand the restructuring and not as a criteria for recognizing a business restructuring.

As a second point, we wish to highlight that also in view of paragraph 9.2. there seems to be a broadening of the scope of the term business restructuring by introducing the 'typical' example of the concentration of functions, albeit with a corresponding reduction in scope or scale of functions carried out locally. We would refrain of calling this a typical business restructuring example, as it is would in our experience often fall either under the (very limited) outsourcing guidance (section E.4.), or more importantly under the notion of "deliberate concerted actions" as discussed in section D.8 of revised chapter I of the Guidelines.

As such, we find it problematic that by introducing this case as a typical example of a business restructuring that a more burdensome transfer pricing analysis and documentation could be requested for under the revised Guidelines that can be adequately dealt with outside the scope of chapter IX. The new paragraph 9.25 of the revised Guidelines in our view effectively demonstrates the superfluity of adding this as an example. Therefore, we suggest removing this typical example from paragraph 9.2. not to necessarily increase the burden of analyzing and documenting such transactions as business restructurings.

Next to the issues highlighted here above we have as such with the, in first instance incorrect and furthermore unneeded, broadening scope of application of business restructurings, our concerns are moreover amplified with the language used in paragraph 9.37 where each business restructuring seems to generate an expectation to require compensation for the restructuring itself.

Not in the least, this would be incorrect for the argumentation referred to in our discussion on the apparent broadening of scope. Moreover, referring to the arm's length principle itself, we think that such presumption again seems contradictory in nature with behavior that we observe with third parties dealing with each other, where indeed first it is determined whether something of value has been transferred effectively. A "willingness to pay"-test therefore in our view seems more in line with the arm's length principle than the presumption stated.

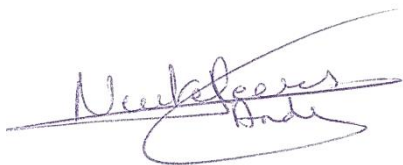
Therefore, we suggest – next to not implementing the proposed changes to paragraphs 9.1 and 9.2 – to rephrase paragraph 9.37 not to include the (perceived) presumption that compensation would be required in any business restructuring, or to include the remark that zero-compensation is an option. We also note that such presumption also can be read in paragraph 9.16 of the Document, and therefore we suggest reconsidering wording there as well.

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In case you would require further clarifications, please feel free to contact us. In the meantime, we sincerely wish to express our hope that the OECD will take into consideration the above comments, and those of business community in view of our joint effort to realize the BEPS objectives, yet with proportionate measures and the arm's length principle as prevailing standard for transfer pricing.

Best regards,

Andy Neuteleers



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August 15, 2016

VIA EMAIL

Pascal Saint-Amans
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Re: USCIB Comment Letter on the OECD Discussion Draft on the amendments to Chapter IX of the Transfer Pricing Guidelines

Dear Mr. Saint-Amans,

USCIB¹ appreciates the opportunity to comment on the discussion draft. We understand that these changes are intended to be conforming changes to Chapter IX and reflect a decision “not to revisit the guidance on business restructurings but to focus attention on changes necessary to address inconsistencies, real or perceived, with the revised chapters, and to remove duplication.” (Page 1 of the discussion draft.)

General Comments

We have observed the restriction concerning not commenting on the aspects of the Guidelines that have been changed by the BEPS Reports or on aspects of Chapter IX which are unchanged. We are somewhat concerned, however, that modifying the Chapter IX guidance for perceived inconsistencies may create real disputes in the future. If helpful guidance that is currently contained in the Chapter IX guidance is deleted because some countries perceive it to inconsistent with the BEPS revisions when it in fact it is not, then those countries may assert additional tax inappropriately and courts and other decision makers may perceive unnecessary deletions as representing a change in policy. Thus, USCIB believes that changes should only be made to resolve real inconsistencies. The specific comments below address additions of text that may create inconsistencies with the BEPS guidance or deletions of text that is not

¹ USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

inconsistent with the BEPS guidance and the deletion of which may, therefore, create unnecessary ambiguities in interpretation of the BEPS guidance.

Addition of functions

The discussion draft revises paragraph 9.2 which would read: “Business restructuring may often involve the centralization of intangibles, risk, or functions with the profit potential attached to them. ...

- The concentration of functions in a regional or central entity, with a corresponding reduction in scope or scale of functions carried out locally; examples may include procurement, sales support, supply chain logistics.”

The language on functions is not in the current version of Chapter IX. We believe this addition goes beyond the mandate for this document, which is to (only) make conforming amendments to Chapter IX to make it consistent with the changes in the final Action 8-10 and 13 reports. Specifically, there is nothing in the final Action 8-10 report which compels this addition. Consequently, it should not be made.

As paragraph 9.1 correctly notes, “There is no legal or universally accepted definition of business restructuring.” Paragraph 9.2 also notes that “Business restructurings may often involve the centralisation of intangibles, risks, or functions with the profit potential attached to them.” (Emphasis added.) But nothing in the existing Chapter IX or in the Final BEPS Reports attempts to set forth precise boundaries as to what does or does not constitute a business restructuring.

We believe that the additional language in the last bullet point in paragraph 9.2 is an attempt to justify imposition of exit taxes in situations where no compensation would be provided among unrelated parties in similar circumstances. Independent companies or unrelated parties frequently reduce functions in a particular jurisdiction, and they do not get paid to do so by their competitors. Consequently, we recommend that the last bullet point in paragraph 9.2 be deleted. If not, we suggest that it be modified to state something to the effect that a reduction in scope or scale of functions would only be considered to be a business restructuring for which compensation is required to the extent that unrelated parties would require compensation in similar circumstances – such as where there has been a breach of a contractual arrangement or where indemnification or severance obligations arise by operation of local law. Otherwise, we believe that this addition would be inconsistent with the rest of the guidance in existing Chapter IX, including specifically the guidance in Section C on “Reallocation of profit potential as a result of a business restructuring,” which specifically does not require compensation for a mere reduction in functions which leads to a corresponding reduction in profit potential.

Changes pertaining to the recognition of the actual transactions undertaken

USCIB recognizes that much of the rewrite of Chapter IX pertains to the changes made with respect to risk and the accurate delineation of the transaction in other parts of the Transfer Pricing Guidelines. Nevertheless, USCIB believes that some of the proposed changes do not address changes necessary to address inconsistencies with the revised chapters or to remove duplication.

Paragraph 9.34 of the discussion draft is based on paragraph 9.163 of the current Transfer Pricing Guidelines. The only substantive difference between the two paragraphs is that the following sentences have been deleted. “MNE groups cannot be forced to have or maintain any particular level of business presence in a country. They are free to act in their own best commercial and economic interests in this regard.”

These sentences are not duplicative and are not inconsistent with the BEPS guidance. Business is very concerned that countries have begun adopting provisions – particularly with respect to the digital economy -- the purpose of which is to force business to maintain a business presence in the local jurisdiction. To the extent that countries are acting unilaterally, those actions, rather than these sentences could be seen as inconsistent with the BEPS guidance and therefore it is important that these sentences be retained.

The Transfer Pricing Guidelines (both the discussion draft and current version) make it clear that domestic anti-abuse rules are not within the scope of Chapter IX. So, domestic rules that require a non-tax business purpose for a restructuring are not implicated by the guidance.

Paragraph 9.37 of the discussion draft is based on paragraphs 9.178 and 9.179 of the existing Transfer Pricing Guidelines. The significant changes to the paragraph are in the following sentence:

“Where a restructuring **makes commercial sense** ~~is commercially rational~~ for the MNE group as a whole ~~on a pre-tax basis~~, it is expected that an appropriate transfer price (that is, compensation for the post-restructuring arrangement plus any compensation payments for the restructuring itself) would generally be available to ~~make it~~ provide arm’s length **compensation for each accurately delineated transaction comprising the business restructuring** for each individual group member participating in it.” (Deletions ~~struck through~~, additions **bold and italicized**.)

Paragraph 9.38 of the discussion draft combines and modifies current paragraphs 9.181 and 9.182. Current paragraph 9.181 is unchanged. However, the discussion draft would delete the first sentence of current paragraph 9.182 which reads as follows: “Provided functions, assets and risks are actually transferred, it can be commercially rational from an Article 9 perspective for an MNE group to restructure in order to obtain tax savings.” This sentence is not inconsistent with the BEPS guidance and therefore should not be deleted.

Paragraph 9.122 through 9.124 of the discussion draft restate Example (B): Transfer of valuable intangibles to a shell company. In the current Guidelines that example is followed by Example

(C): Transfer of Intangible that is recognized. The main point of Example (C) is that even though a restructuring had a tax purpose, if the people and activities actually moved the transaction is respected. So, it is an illustration of the deleted sentence from paragraph 9.182. The addition of “pre-tax basis” seems to build some notion of non-tax business purpose in the Article 9 guidance. There is a sentence in the recently adopted BEPS changes (which is cross-referenced in paragraph 9.38 of the discussion draft) that provides as follows:

“It is also a relevant pointer to consider whether the MNE group as a whole is left worse off on a pre-tax basis since this may be an indicator that the transaction viewed in its entirety lacks the commercial rationality of arrangements between unrelated parties.” (Paragraph 1.122 of the post BEPS revised guidelines.)

The sentence that is proposed to be deleted from 9.182 – which acknowledges that transactions can have a purpose related to saving taxes and be commercially rational -- and the added sentence that is cross-referenced in paragraph 9.38 – which acknowledges that being worse off on a pre-tax basis may be an indication of that the transaction lacks commercial rationality -- are both consistent with the BEPS guidance and consistent with each other. Both are conditional “it can be commercially rational” and “this may be an indicator”. These sentences are attempting to define a difficult to identify border; that is the border between acceptable tax planning and unacceptable tax planning. Deleting the sentence and the example make the location of that border less clear. Further, USCIB believes that the deleted sentence and example are neither inconsistent with the BEPS guidance nor duplicative of other guidance (the standard articulated by the OECD for making changes to Chapter IX) and, therefore, both the deleted sentence and the deleted example should be added back.

USCIB is not suggesting that commercially irrational transactions should be respected, but a tax purpose by itself should not cause a transaction not to be respected. Deleting the quoted sentence and the example, seems to imply that a tax purpose would taint the transaction even if functions and assets moved and the group as whole was better off on a pre-tax basis. This result seems inconsistent with the fundamental principle expressed in paragraph 9.9 of the discussion draft and the current version of the guidelines that the arm’s length principle “should not apply differently to restructurings and post-restructuring transactions than to transactions that were structured as such from the beginning.” If a restructuring is not respected merely because a tax purpose may be one element of a restructuring that moves functions, assets and risks and leaves the MNE group better off on a pre-tax basis, then that principle will be violated.

Deletion of paragraph 9.122

Paragraph 9.122 currently reads as follows:

There can also be cases where neither A or C would be willing to bear the indemnification costs at arm’s length because neither of them expects to derive sufficient benefits from the changes. It can be the case that such termination is part of a

group-wide restructuring decided by the parent company P in order to derive group-wide synergies, and that the indemnification of B should be borne by P at arm's length (unless, for example, B, notwithstanding that its contract has been terminated or renegotiated, derives benefits from group-wide synergies that outweigh the cost to it of termination of renegotiation).

The first sentence of paragraph 9.97 of the discussion draft contains the only sentence in current paragraph 9.121 and the following new sentence:

In cases where the benefits arising from the restructuring accrue to another party in the MNE group, then that other party may bear the costs of the indemnification, either directly or indirectly.

This new sentence seems intended to replace existing paragraph 9.122, acknowledging that another party may bear the restructuring costs. While this sentence is helpful, existing paragraph 9.122 is consistent with the BEPS guidance and not duplicative of other guidance in the final BEPS reports and is clearer than paragraph 9.97 of the discussion draft. As the scenario presented by paragraph 9.122 is common in business restructurings, including paragraph 9.122 provides useful guidance. USCIB therefore recommends that paragraph 9.122 be included in the final version of Chapter IX.

Sincerely,



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Comments on Public Discussion Draft: “CONFORMING AMENDMENTS TO CHAPTER IX OF THE TRANS- FER PRICING GUIDELINES”

Dear All,

WTS is pleased to provide you with comments regarding the OECD Discussion Draft
“Conforming Amendments to Chapter IX of the Transfer Pricing Guidelines”.

We appreciate the OECD’s effort to provide guidance on this important topic and as-
sess the provided draft as a very comprehensive and valuable basis for further dis-
cussions.

We also very much appreciate the OECD’s general course to implement the principle
of “economic substance over legal form” as defined by the OECD 2015 BEPS Reports
as the relevant standard for the analysis, determination and review of transfer pricing
arrangements.

Accordingly, we would like to emphasize that we respect the OECD’s instructions not
to comment on aspects of the Guidelines which have been changed in the 2015 BEPS
reports and not to comment on the guidance on business restructuring itself.

However, our overall impression is that various of the amendments proposed in the
actual OECD Discussion Draft “Conforming Amendments to Chapter IX of the Trans-
fer Pricing Guidelines” seem to materially affect and change the existing understand-
ing and evaluation of business restructurings for transfer pricing purposes and accord-
ingly may not only be qualified as being of “conforming” character.

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Therefore, we would like to take the opportunity to comment on the underlying OECD Discussion Draft with a special focus on the concerns of WTS about the new approach of “economic substance over legal form” for the evaluation of business restructurings for transfer pricing purposes.

Again, we want to point out that WTS fully supports the principle of “economic substance over legal form” for transfer pricing purposes and the analysis and evaluation of business restructurings as introduced by the OECD in the current Discussion Draft.

Nevertheless, it clearly has to be noted that exclusively focusing the transfer pricing analysis on “people functions” and the approach that business risks have obligatory to be allocated in accordance with the allocation of people functions completely independent from the contractual risk allocation between the (related) parties, represents a significant departure from the existing international standards and practice of analyzing and reviewing transfer pricing arrangements, especially with regard to business restructurings.

It reflects our understanding of the BEPS Action plan that the OECD does not only want to consider the perspective of the tax authorities but also acknowledges the necessity for Multinational Enterprises (MNE) to achieve tax risk assurance, to avoid double taxation as well as penalty protection.

Accordingly, we would like to emphasize two major aspects, which the OECD may wish to examine further as part of its considerations in this area. Some additional comments are summarized in bullet-points at the end of this letter.

1. New Interpretation of the Arm’s Length Principle (people functions vs. contractual risks)

Based on our experience, the principle of “substance over form” has always been recognized in international practice for transfer pricing purposes by tax administrations as well as by MNEs engaged in significant intercompany business.

However, it has also been the international practice that the contractual terms and conditions of a business relationship form the starting point for the transfer pricing analysis. This means that essentially, the contract has been the basis for any transfer pricing evaluation and it has been reviewed in the first instance whether the contractual arrangement is in line with market conditions i.e. does the contract between the related parties reflect what independent third parties would have agreed in a contract under comparable circumstances on the open market.

The principle of “substance over form” has then been applied as a second step of the transfer pricing analysis, in order to verify whether the actual behavior of the related parties does in fact reflect what has been agreed in the contract.

Accordingly, the principle of “substance over form” was established to avoid, that related parties do enter into a contractual arrangement, which fully complies with market requirements; however, actually the parties perform the intercompany transaction in a totally different way than it has been contractually agreed.

As a result, the principle of “substance over form” could have been qualified as an anti-avoidance rule under the application of the arm’s length principle, however, it has not been an individual rule to assess functions, risks and the analysis of the value chain.

It was our understanding during the BEPS project that this principle should be kept as the basis for the transfer pricing analysis also under the “people function approach”.

However, when reading the current Discussion Draft it is our impression, that the contractual arrangements between the related parties shall no longer be the starting point for the transfer pricing analysis, but the transfer pricing analysis shall be based on the analysis of activities of individual employees of the MNE and qualifying their activities in relation of the overall value-chain for the respective product or services or the overall business of the MNE.

Especially, the focus on “activities to control risks”, seem to be a core element of the application of the new principle of “substance over form” transfer pricing analysis, see for example section B.1.1.

Our concern in that regard is, that the approach of allocating risks focused on people’s activities may lead to a different interpretation of the arm’s length principle purely for tax purposes, which does no longer comply with market conditions between unrelated parties on the free market, because realistically it can be recognized that bearing of risks is of course an issue of the legal contract in place independently from people’s activities. Of course, it can be realized on the market that risks do materialize in accordance with contractual risk allocation and not in accordance with people’s behaviors.

The judgement of contractual terms is of course also the sole standard for courts when it comes to legal proceedings between independent third parties. So that means, that courts would never base their decision on the fact which people have or have not performed an activity or should have performed this activity.

Accordingly, that would mean that the result of the evaluation of a business relationship between unrelated third parties based on civil law aspects may be totally different than the result of the same business relationship between related parties based on the principle of “substance over form”. Based on our understanding this shall not be the OECD intention when introducing the substance based transfer pricing analysis.

One example of this new view is given in section E.2.1 of the Discussion Draft. In that section it is outlined that “legal ownership of an intangible by itself does not confer any right ultimately to retain returns...derived from exploiting that intangible”. This general assumption is not in line with market conditions, because of course there are very many transactions on the market between unrelated parties, where one party buys an intangible from another party and accordingly is fully authorized to retain the respective returns from that intangible, without performing any further or only very limited further economic functions. Especially in the Private Equity sector it is a very common business model to invest in (start-up) companies developing new valuable business models and intangibles. In such scenario, the Private Equity investors are not involved in the actual business and do not perform any material economic functions for their investment. However, in case the investment is successful, the full return or at least major parts of the investment are absorbed by the investors.

We understand that under such scenario, the evaluation of the transactions for tax purposes based on the “people functions approach” very likely will lead to a totally different result, which obviously does not reflect market conditions and behavior between unrelated parties.

Accordingly, our concern is that on the basis of the “people functions approach” local tax authorities feel encouraged to reallocate risks and accordingly ownership in intangible assets more or less just based on their subjective evaluation of local people’s activities, without respecting what has been legally agreed between the parties.

On the other hand, we are very worried about the fact that the actual approach defined by the OECD may be interpreted by (certain) tax authorities as a kind of a “freedom of choice” situation, meaning that in case of a loss making transaction the losses are assessed in accordance with the contractual terms. However, in case of profits the contractual terms will be rejected and profits shall be allocated on the basis of people’s activities respectively the tax authorities interpretation of that .

In the end that would mean a high and unforeseeable risk of double taxation for MNEs as valid legal agreement may not be respected by tax authorities and no clear guidance is available for MNEs which activities need to be performed, by which people and at which point of time, in order to reach a certain level of certainty against arbitrary tax audit objections.

We would therefore recommend that the OECD does express the clear commitment that a valid legal agreement has to be accepted also for tax purposes and that the tax qualification of a transaction between related parties has to follow the terms and conditions of the legal agreement as long as the agreement is in accordance with market conditions and the actual behavior of the related parties complies with the terms of the agreement.

The possibility for tax authorities to requalify a transaction based on their individual assessment of people functions and activities should clearly be restricted to cases, where there is an obvious mismatch between the contract and the actual behavior of the parties.

It should be clear from the OECD's recommendations that the "people functions approach" is a anti-avoidance rule to avoid inappropriate tax structuring but should not be the standard to assess the functions and risks of a transaction by completely rejecting the valid legal agreement underlying that transaction.

The underlying contractual arrangement and the relation to the principle of "substance over form" is of course also a very relevant aspect of business restructurings which should be reflected and emphasized by the OECD in the actual Discussion Draft.

2. Tax Authority as the "more prudent entrepreneur"

In addition, we do have concerns about how the new approach of analyzing the transfer pricing impacts of the complex structures and business models of MNEs based on "people functions" should be implemented in practice – on the one hand by the MNEs themselves, but especially on the other hand by the tax authorities.

As to our understanding, the evaluation of value chains, individual functions and risks within such value chain and their respective contribution to that value chain as well as the relative value proposition of people's activities to create a function, does require an in-depth understanding and comprehensive knowledge of the business and the individual economic environment to that business (which may even be totally different for regional markets of the same product).

This of course especially applies to business restructuring transactions as described in the current Discussion Draft.

For example, in 9.22 of section B.1.1 the tax authorities are required during the audit of a business restructuring to perform an analysis of the "significance of a risk" and the "likelihood of the risk materializing".

In addition, according to 9.28 of section B.3. the tax authorities need to "consider the economically relevant characteristic's taken into account by the parties in reaching the conclusion that the restructuring adopted offers a clearly more attractive opportunity to meet commercial objectives than alternative options realistically available."

As mentioned above, WTS is fully aware that transfer pricing and especially business restructurings require comprehensive economic circumstances of each individual case, however, we also fear that in practice, there are very few economists available at tax authorities in many countries.

In addition, a decent economic analysis of a business restructuring including the “commercial objectives” of all available options would obviously require a proper period of time for the analysis – besides the economic knowledge and understanding.

Overall, our impression is that tax authorities are requested to become the “more prudent business men” as they are required to fully understand each of the individual business models of the various MNEs in totally different industries.

During the tax audits the tax authorities will be required to economically understand the business and management decisions and measures of the respective MNE to accept a business restructuring or to requalify the restructuring for tax purposes, if according to their evaluation an alternative restructuring would have been more beneficial for the MNE. So far, it seems to be not quite clear how such information shall be gathered by tax authorities during a tax audit e.g. by performing on-site functional interviews with relevant decision makers and management of the MNE? That would be a totally new approach to tax audits for tax authorities as to our experience.

As a result, it could be summarized that in practice MNEs may face significant tax risks and uncertainties, due to the fact that tax audits may not be performed with diligent care and time that would be required to understand the business restructuring and the tax impacts to be considered.

It should also be recognized in that regard that within a MNE, in practice most of the entrepreneurial risks are ultimately controlled and managed by the parent entity as the strategic leader of the group. However, based on the OECD’s interpretation, we do have concerns that local tax authorities feel encouraged to reallocate risks and accordingly ownership in intangible assets to local entities more or less just based on their subjective evaluation of local people’s activities. In the end that would mean a high and unforeseeable risk of double taxation for MNEs.

From our perspective it should clearly be avoided that the “people functions” approach will be abused by tax authorities as a possibility to make arbitrary adjustments and MNEs have to face various discussions with many tax authorities globally about their value chains and the relative contribution of individual people functions and activities to these value chains without having the legal security of a binding arbitration solution to solve the double taxation.

In that regard it should be considered by the OECD that double taxation can lead to adverse effects on growth and global prosperity. MNEs need certainty and predictability to ensure sound investment decisions, especially for business restructurings.

Accordingly, we would recommend that the mutual arbitration procedure (MAP) would be mandatory and binding and to be finalized in a certain time frame, to protect MNEs against arbitrary transfer pricing adjustments by certain tax authorities. We would propose the EU Arbitration Convention as an example and format for such binding arbitration rules, which should be signed by tax authorities in all countries implementing the BEPS recommendations or parts of it. Otherwise the BEPS initiative may end an unilateral burden for MNEs with no obligation for tax authorities to release MNEs from double taxation.

3. Additional Comments by WTS

- **Sec. D. “Reallocation of profit potential as a result of a business restructuring”**

According to our understanding “profit potential” does not qualify as an individual intangible asset, which could be transferred independently from any other assets of the business. Profit potential according to our understanding is something that is inseparable connected with the going concern of a business or function.

Accordingly, we understand that the value of the profit potential has to be considered for the valuation of the intangible assets transferred as a result of the business restructuring.

As a result, it may be considered that sec. D. may be integrated in sec. E.

- **Sec. D. 9.46 Example**

The example in sec. D. 9.46 shall illustrate the alternative scenarios that may be relevant for the business restructuring of a distributor.

The example gives the impression that the starting point for the evaluation of the business restructuring especially focusing on a potential compensation claim for the distributor subject to the restructuring is always the profits of the past or future years.

However, according to our understanding this does not adequately reflect the arm's length principle as the starting point for this analysis should always be the contractual terms agreed between the parties and the existence of potential legal claims. This would at least be the situation between unrelated parties.

As a result, it should be clearly stated in that example that there may also be situations where the distributor subject to the restructuring will not have any claim although significantly losing future profit potential (e.g. termination of distribution agreement in accordance with the agreed terms and conditions).

- **Sec. D. 9.47**

In this section reference is made to the “level of risk tolerance” of the respective parties involved in the business restructuring. We agree, that of course the individual willingness to carry a risk or not, is a very important factor when it comes to business decisions, especially with regard to major business restructurings. However, we do not underhand how tax authorities shall evaluate this factor when auditing the tax impacts of a business restructuring.

From our perspective, clear guidance would be required that entrepreneurial decisions should in any case have to be accepted by tax authorities, and that tax authorities are not allowed to requalify the business restructuring or make any adjustments just on the basis of their individually different evaluation of the willingness to carry a risk or not.

- **Sec. E.2 9.55**

According to our understanding a “customer list” is something entirely different than a “customer base”. We understand that a “customer list” more or less is the information about names and addresses of customers, whereas the customer base constitutes an existing (long-term) relationship with customers. This should in our view be considered for the discussion of the qualification of intangibles and the OECD may consider including this difference in the current Discussion Draft.

- **Sec. E.2 9.61**

In this section an example is given were the OECD assumes a business restructuring which should not be in accordance with the arm’s length principle. The OECD states that, it is likely that at least one of the two prices are not arm’s length in the example that one party sells a patent to another (related) party at a price of 100 and will continue to use the patent transferred for a license of 100 per year over a 10 years period.

In that we want to express our concern that the example given – without any further explanations and guidance – may encourage the tax authorities to make adjustments just based on figures and financial figures without spending too much effort on reviewing and analyzing in detail the circumstances surrounding such transaction.

Of course, we agree that the figures given in the example seem to be representative for a case in which a business restructuring has been abused for tax avoidance reasons only. However, we want to point out that depending on individual situations and economic circumstances, comparable situations between unrelated parties may be recorded on the free market. For example, when the technology subject to the transfer requires significant ongoing R&D investments. The example given in sec. E.2 would result in a different scenario, if it would be added that the li-

censee saves annual R&D expenses in the amount of 80, which after the restructuring will be absorbed by the new technology owner. There are also “sale and lease back” transactions recognized between unrelated parties on the market, where the pure evaluation of the ratio between purchase price and ongoing fee for usage may indicate that the transactions may qualify as incorrect or abusive. However, when looking at the overall economic situation, there are mostly sound reasons why such transactions have to be qualified as wise economic decisions although the pure financial ratio seems to be unprofitable for the transferor.

As a result, we have concerns that the example in section 9.61 maybe interpreted in a way that business restructuring could be evaluated purely on the basis of the financial ratio between purchase price and ongoing usage fee, which may be too simple and not always in accordance with the arm’s length principle. Accordingly, it may be useful to give some more explanations to the example or just leave it out.

We hope that our comments are useful for the further discussion of this important topic.

Kind regards,

WTS Steuerberatungsgesellschaft mbH

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