UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

Mr. Pascal Saint-Amans
Director
OECD Centre for Tax Policy and Administration (CTPA)
2, rue André Pascal
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May 24, 2012

Dear Mr. Saint-Amans:

The United States Council for International Business appreciates the opportunity to provide comments on the Transfer Pricing Needs Assessment Tool recently presented at the third plenary meeting of the Task Force on Tax and Development. We look forward to working with the OECD and the Task Force as it refines this tool.

USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and regulatory coherence. Its members include 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.

Our members support the use of a well-designed needs assessment tool. In the global economy most countries will eventually determine that they need to develop transfer pricing rules, so it is useful to think carefully about the issues involved with the design and implementation of transfer pricing rules in advance. Better understanding of both business and transfer pricing principles will lead to fewer arbitrary adjustments and better focus on the genuine issues. Overall, our members think the tool is a good step forward. There are, however, a few areas of concern set forth below. To the extent that these issues are raised in multiple sections of the draft assessment tool, the comments would apply to all those sections.

In step one the first box recommends identifying and analyzing the tax return and accounts of the largest 25 (or 20?) corporate taxpayers. There are a couple of issues with this. First, the largest taxpayers may be the most compliant. They may be paying so much tax because they are following the rules. Smaller taxpayers may be smaller because they have inappropriately

reduced their tax burden. Another measure of size such as gross income or effective tax rate on gross income may be more appropriate for purposes of determining which companies ought to be the focus of more sustained inquiry.

Also in step one the second box sets forth numerical standards for determining whether royalty rates, management fees and service fees are too high. The third box mentions a history of loss-making. There are disclaimers that these factors are just indicators requiring further exploration. The members of USCIB are nevertheless concerned that the countries will view the numerical thresholds as unsafe harbors and require adjustments if royalties, management fees or service fees exceed these thresholds and disallow legitimate losses. There is no easy way to address this concern; however, we believe that the assessment tool needs to emphasize that transfer pricing requires careful review of the particular facts and circumstances and fixed returns do not accurately reflect an arm's length return.

The third box raises as a risk factor transactions involving a low tax jurisdiction. The converse of this ought to also be taken into account. That is, if transactions involve other countries with similar tax rates, then the risk of profit shifting is less and that factor ought to be considered.

The section on additional analyses (page 6 of the draft) suggests conducting interviews with the largest MNEs and suggests information that might be sought. We suggest adding a final bullet point along the following lines:

> Any global standard transfer pricing policy with respect to intercompany transaction affecting the jurisdiction, e.g. consistent cost-plus policy for manufacturing and services, consistent allocation keys for HQ services, consistent royalty charge.

As discussed below, companies with consistent global policies should be seen as lower risk.

Under step 1 for FDI companies, one of the comments in the sixth box provides that taxpayers may over comply in jurisdictions that have transfer pricing rules in place. A multinational is usually dealing with multiple jurisdictions and will usually have a global transfer pricing policy in place. This typical arrangement does not permit over compliance in one jurisdiction at the expense of another jurisdiction because the global transfer pricing policy must be applied consistently worldwide. The existence of a global transfer pricing policy leaves less room for tax planning with respect to transactions covered by that policy.

The second bullet in the section on assessment (page 6 of the draft) provides that "if it is established that significant transaction risk is confined to taxpayer companies in a specific sector, or a small number of sectors, it may be appropriate to initially restrict the application of transfer pricing rules to that sector." We are concerned that this language combined with the

emphasis in step 1 on numerical standards will push industries in which returns are higher into these categories inappropriately. To mitigate this risk, we suggest adding language along the lines of the following after the first sentence of the second bullet:

> Care must be taken in identifying particular sectors because returns in different industries vary significantly. Thus, companies in some industries may earn returns that appear high (and that are higher than the figures in step 1, box 2) but that are routine in that industry. These companies and industries do not necessarily represent a significant transfer pricing risk.

The sixth box of step 3 provides that "it will be necessary to consider introducing rules that ... impose penalties where a) inadequate documentation is maintained and/or b) taxpayers get their transfer pricing wrong." It is inappropriate to impose penalties when no additional tax is due. The issue of documentation is a very sensitive one. There is no consistency among countries in the documentation that is required. Taxpayers spend millions on complying with the differing and onerous documentation rules and should not be subject to penalty for a documentation failure that does not result in underpayment of taxes.

The third category, building skills, under Step 3 discusses the program of training necessary for auditors. Training auditors is critical to implementing a transfer pricing regime. We believe it is important to emphasize that functional analysis is not just a part of the search for comparables, but is an integral part of understanding business taking place in country. This training should be coupled with training on the economics of key industries including those represented in the top 25 taxpayers/FDI companies. As we pointed out at the beginning of this letter, better understanding of business is essential to identifying genuine issues and avoiding arbitrary adjustments.

USCIB would also like to raise three issues that are not dealt with directly by the assessment tool. First, the assessment tool should provide some cautionary language on the risk of double taxation. There is very little in the document that suggests that there is a possible down side to aggressively pursuing transfer pricing cases. Taxpayers are obligated to pay the amount of tax legally owed in the countries where they do business. However, countries should consider that that transfer pricing is not a precise science and that there is a range of acceptable prices. Aggressively pursuing transfer pricing adjustments that result in double taxation may discourage foreign direct investment. A corollary of this point is that the risk of double taxation may arise not only from aggressive enforcement, but also, and perhaps more importantly, from rules that deviate from global norms. Business needs consistency and certainty with respect to its tax obligations. Countries that fail to provide these conditions will likely see reduced FDI over the long term.

The risk of double taxation leads to the second issue, the assessment tool should emphasize that implementation of transfer pricing regimes should go hand-in-hand with developing a treaty network that can assist in resolving transfer pricing cases (and other issues arising in the area of cross-border taxation).

Finally, the assessment and implementation tool should suggest the coordination of tax rules with other rules. For example, if the transfer pricing rules would permit the payment of a royalty or management fee, other rules (such as bank clearance requirements) should not prohibit that payment.

We look forward to continuing to work on refining the transfer pricing needs assessment and implementation tool.

Sincerely,

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United States Council for International Business (USCIB)

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