June 30, 2011

Mr. Jeffrey Owens
Director
Centre for Tax Policy and Administration
OECD

Subject: BIAC Comment to OECD on the OECD’s Project on the Administrative Aspects of Transfer Pricing

Dear Jeffrey,

BIAC appreciates the opportunity to submit comments on the OECD’s project on the administrative aspects of transfer pricing (the “Chapter IV project”). This project is of considerable interest to BIAC’s members.

Multinational taxpayers and tax administrations stand at a crossroads with respect to transfer pricing administration. The direct and indirect costs of transfer pricing compliance for multinational taxpayers and enforcement for tax administrations have increased substantially in the years since the release of Chapter IV of the OECD Transfer Pricing Guidelines (the “Guidelines”). Further, there are new stakeholders within the global transfer pricing community whose views on administration and enforcement must also be taken into account. BIAC believes that the OECD is uniquely situated to develop and, in some cases, revise standards and encourage practices that will promote fair, effective, and efficient transfer pricing administration, enforcement, and compliance. This letter offers observations and recommendations on identifying such standards and practices.

Of specific concern to BIAC’s members in this area are the compliance challenges they face in developing, implementing, and defending their transfer pricing policies covering non-core routine intercompany transactions, particularly intra-group services transactions. Two main issues regularly arise. First, it is not uncommon for tax inspectors to lack experience and awareness of the administrative, organizational, and managerial challenges that multinational taxpayers face in applying the arm’s length standard to the volume and diversity of non-core intercompany transactions they undertake in the normal course of business. This can lead to miscommunication and confusions during audits and, unfortunately, to accusations of transfer pricing manipulation. Second, multinational taxpayers face a patchwork of individual country transfer pricing regimes that, while ostensibly similar in content, can differ widely in their application. This creates considerable uncertainty for taxpayers in transfer pricing controversies.
BIAC is hopeful that the OECD will use the Chapter IV project to address these issues by identifying the common ground that exists between arm’s length transfer pricing principles and practical, administrable transfer pricing policies and practices. In the interest of assisting the OECD in this regard, this letter offers comments on the guidelines covering low-value services transactions recently endorsed by the European Union, on the merits of adopting safe harbors covering intra-group non-core services and other non-core intercompany transactions, and on certain issues surrounding advance pricing arrangements (“APAs”) and mutual agreement (“MAP”) cases.

I. General Remarks on the Context of the Chapter IV Project

A. Relationship to Revisions to Chapters I through III

BIAC would like to begin with some reflections on how the recent revisions to Chapters I through III of the Guidelines might serve as a guide and benchmark for what can be achieved in the Chapter IV project.

BIAC’s members have welcomed the revisions made to Chapters I through III because they represent fair and balanced principles that are responsive to the practical challenges that taxpayers and tax authorities face in applying the arm’s length principle. The adoption of the “most appropriate method” standard is the leading example of this effort. From a practical perspective, the adoption of this standard is important because of its potential to narrow the scope of transfer pricing audit controversies. Indeed, in its comments on the prior project, BIAC complimented the OECD for recognizing that the inflexible hierarchy of transfer pricing methods contained in the prior language of the Guidelines was out of step with current transfer pricing practices and thus led to controversies in too many situations. While some tax administrations were known to have rejected (sometimes systematically) the Transactional Net Margin Method (“TNMM”) on the grounds that it was a “method of last resort”, such determinations were inconsistent with the widespread acceptance that the TNMM could be applied reliably. However untested it might have been when it was introduced, the TNMM had come to be used in enough contexts and in enough jurisdictions that standards of reliability governing its adoption were recognized and followed by taxpayers, tax administrations, and practitioners alike.

The “most appropriate” method standard exemplifies a balanced and practical approach to transfer pricing administration that advances the interests of both taxpayers and tax authorities. Transfer pricing rules that are based upon reasonable, identifiable principles give multinational taxpayers confidence that their transfer pricing policies will be respected, thus stabilizing their compliance costs. Tax administrations have similar interests in promoting rules that encourage compliance with the most efficient allocation of scarce examination resources.

BIAC believes that a similarly balanced and practical approach should guide the assessment and revision of Chapter IV. Transfer pricing is inherently driven by facts and circumstances, but there are enough areas of consistency and uniformity in the application of the arm’s length standard that “best practices” can be incorporated into guidance on methods and documentation, particularly with respect to routine
non-core intercompany transactions. BIAC hopes that the OECD will see the Chapter IV project as an opportunity to identify and foster these practices.

B. **Relationship to Intangibles Project (Chapters VI and VIII)**

BIAC recognizes that there will be areas of overlap between the Chapter IV project and the intangibles project covering Chapters VI and VIII. One aspect of this overlap that BIAC wishes to mention is that not all intangibles or contributions are “unique”, and thus that not all intercompany transactions in which intangibles may be involved will require the same degree of scrutiny. As further discussed below, “one-sided” transfer pricing methods (i.e., not profit splits) may be appropriate even when intangibles are present or involved, such as when the intangibles are “routine” or when a return to such intangibles over and above a “routine” functional return can be determined. Having this perspective in mind will be important when considering the intersection of services and intangibles transactions.

C. **Relationship to Initiatives on Tax and Development**

BIAC recognizes that tax administrations of developing and transitional countries have a legitimate interest in ensuring that MNEs apply fair, non-discriminatory transfer pricing policies to transactions within their jurisdictions. In this regard, BIAC is sensitive to the fact that developing and transitional countries face particularly difficult challenges in enforcing the arm’s length standard, generally emanating from their need to develop more robust and effective transfer pricing examination capacities. Certainly, these issues must be confronted, which is why BIAC has made several contributions to the OECD’s Task Force on Tax and Development. BIAC regards the Chapter IV project as an important opportunity to continue the dialogue on these important matters, such that the interests of all stakeholders in the application and enforcement of the arm’s length standard have been considered.

II. **Transfer Pricing Practice: Day-to-Day Administrative Questions and Issues**

Certain transfer pricing issues – notably, business restructurings and other transfers of high-value intangibles – present complex legal and economic questions. The questions that occupy the attention of tax directors on a day-to-day basis, however, are generally less complicated. However, they can involve compliance challenges that are sometimes even more substantial in the aggregate.

To state an obvious, but nevertheless important and relevant, point, BIAC’s members enter into literally thousands of intercompany sales, services, financing, and other transactions every taxable year. In order to manage this volume of intercompany transactions, different departments within the organization are tasked with developing policies and procedures for the activities they oversee. In general, these policies and procedures are developed and are meant to be applied in a global and seamless way, so as to achieve predictability and administrative efficiency. However, in the course of business, different global policies do not always interact with each other seamlessly, and they cannot always be applied without exception. Accordingly, the internal management task facing the organization is to find the right balance between developing and adhering to global policies while still
maintaining the ability to respond quickly and efficiently to regulatory, organizational, and administrative challenges when they arise.

Bearing this in mind, it is important to appreciate a common problem faced by BIAC’s members: tax inspectors too often do not seek to work cooperatively with taxpayers to understand the organizational, administrative, and managerial questions that they face in applying the arm’s length standard to intercompany transactions— not transactions involving “crown jewel” intangibles, but entirely routine, run-of-the-mill services, distribution, manufacturing transactions, and all non-core business. This lack of understanding on the part of tax administrations can be a main source of controversy, and, discouragingly, can give rise to suspicions of transfer pricing manipulation.

BIAC believes that the Guidelines should strongly re-emphasize that there is a difference between aggressive transfer pricing manipulation and prudent, reasonable transfer pricing planning. Further, the Guidelines should strongly recommend that deviations from global policies be examined in light of the administrative, commercial, and organizational contexts in which they arise and not be immediately construed as evidence of transfer pricing manipulation.

The following are examples of the kind of day-to-day transfer pricing questions that BIAC hopes the OECD will consider in this regard:

- **Intercompany Invoicing and Related Issues**: It has been the experience of some BIAC members that tax inspectors are troubled by differences between the form and level of detail that is found in intercompany invoices or intercompany agreements relative to what is included in third party invoices or agreements. For example, intercompany invoices may fail to specify the currency or collection terms, while such terms are specified in third-party invoices. What can go unappreciated by the tax inspector is that the difference is explained by the fact that operating manuals and standards set for business units within the multinational group may require that, for example, intercompany transactions be processed according to the terms of underlying transactions with customers, or that certain transactions be processed in one location versus another. Multinational companies may need to have this kind of flexibility in their procedures in order to be able to efficiently manage the volume of intercompany transactions that are processed in relation to single customer transaction. In this vein, the OECD should urge tax administrations to respect a taxpayer’s intercompany invoicing and related documentation and question it only when there is evidence of abuse or if the manner in which such documentation is prepared affirmatively prevents the tax administration from being able to examine the intercompany transactions.

- **Aggregation Questions**: Tax inspectors have been known to challenge isolated transactions of a subsidiary, even when the subsidiary’s overall profits from engaging in intercompany transactions are arm’s length in the aggregate. The assumption maintained by the tax inspectors in such cases is that the examined transactions have been manipulated, notwithstanding the aggregate results. While this possibility cannot be ruled out as a
conceptual matter, this assumption ignores the fact that product lines may have different launch dates, expected sales volume or profits, paths to maturity and times to obsolescence, and so on. The administrative complexity involved in handling the variety of product factors that affect pricing militates in favor of aggregating transactions according to criteria that are commercially reasonable. Barring some evidence of abuse, such aggregation practices should be respected by tax administrations when the overall operation is within the arm’s length range.

- **True-up to Profit-Level Targets**: It is an all too common occurrence that tax inspectors challenge “true-up” payments that bring a tested party’s results into a set arm’s length range. The problem that lies behind the need for true-up payments is a familiar one. Due to normal business volatility, it is not always possible to set intercompany prices in such a way that a tested party is ensured an arm’s length profit at the end of the taxable year. The remedy is a true-up payment or similar mechanism. Some tax inspectors, however, do not accept this concept and maintain that such payments are indicative of transfer pricing manipulation (even though the subsidiary ultimately receives an arm’s length profit). While frequent use of true-up payments or payments of a certain size may provide justification to a tax inspector to investigate the intercompany transactions further, the mere fact that a true-up payment is received should not.

BIAC would appreciate the opportunity to elaborate on these and other examples of the administrative and organizational realities that its members face. Such information will be important for developing principled and pragmatic guidance on transfer pricing compliance.

**III. Transfer Pricing Practice: Compliance Questions and Issues**

**A. General Comments**

In addition to administrative questions and issues that arise on a day-to-day basis, BIAC’s members also face a variety of challenges in demonstrating their compliance with the arm’s length standard.

On this point, BIAC believes that one of the most important contributions that the Chapter IV project could make would be to provide an expansive discussion of the “best practices” taxpayers should follow in developing, implementing, documenting, and defending their intercompany transfer pricing policies. To be clear on this point, BIAC believes that “best practices” are those that provide tax administrations with the information they need to confirm that the arm’s length standard has been correctly applied, while at the same time give taxpayers confidence that they will achieve the certainty, timeliness, and impartiality of outcome they seek on audit if they demonstrate a good faith effort to apply the arm’s length standard and maintain sufficient documentation evidencing their attempt to do so. What is disconcerting to BIAC’s members is that in their experience, too many transfer pricing examinations do not seem to reflect this reciprocity. This aspect of transfer pricing administration needs improvement.

The current language of Chapter IV and other relevant chapters of the Guidelines reflects these concerns to some extent, but they are significant enough to be underscored. Tax departments of multinational
taxpayers incur significant costs to produce transfer pricing documentation, whether it is prepared by consultants, in-house, or some combination of the two. While certain multilateral initiatives are intended to find ways to reduce this cost (notably, the guidelines of the EU Joint Transfer Pricing Forum (“EU JTPF”) on low-value intra-group services, discussed below), it still represents a significant burden that should be addressed. BIAC believes it is possible to do this without sacrificing the legitimate needs of individual tax authorities.

It is also important to note that, as significant as they might be, the costs of preparing documentation are not the main source of concern for BIAC’s members. Rather, multinational taxpayers develop and apply global transfer pricing policies in an effort to reduce the uncertainties of transfer pricing audits and the effects of such uncertainties on financial reporting. The concern of BIAC’s members is that even their best efforts to develop and apply arm’s length global policies do not reduce the uncertainties of transfer pricing compliance in many jurisdictions.

In this vein, the following is a non-exhaustive list of some of the challenges BIAC’s members have faced with their intra-group services policies and which they hope will be addressed by the Chapter IV project:

- Tax jurisdictions have been known to hold sometimes radically different interpretations of basic definitions, such as that of a “stripped” distributor, and concepts, such as the composition of shareholder costs.

- Tax jurisdictions have also differed regarding when a benefit has been provided to a related recipient of a service or which allocation key may be appropriate to use in a given case. When conceptual disagreements between tax authorities develop on such issues, taxpayers often face the possibility that certain costs may not be deductible, in part or in full, in different jurisdictions.

- Tax jurisdictions vary on their insistence that local comparables be included in transfer pricing analyses, even when the transactions involve services that are sufficiently mobile to warrant examination of regional (or broader) sets of comparables.

- As suggested above, tax jurisdictions are known to maintain sometimes inconsistent documentation requirements. Such requirements can differ in any of a number of ways, including the content of the documentation, the language in which the documentation must be prepared, the order in which topics are addressed in the documentation, and the duration between updates and the scope of review required of updates, e.g., the extent to which a study may be “rolled forward” by updating data for an existing set of comparables rather than performing the transfer pricing analysis anew.

- Some countries routinely exclude deductions of certain costs such as management fees, rather than allow proper transfer pricing to provide the business purpose of the deduction. Such exclusions lead to international distortion of balanced taxing powers and double taxation.
Once again, these are a handful of examples of discrete, but nevertheless significant, issues that can make transfer pricing compliance inordinately complex and fraught with inconsistencies and uncertainties, particularly for BIAC’s members, given the global scope on which they operate.

B. **Comments on the EU JTPF Guidelines**

BIAC believes that one step that the OECD could take to address such concerns would be to consult the guidelines developed by the EU Joint Transfer Pricing Forum (“EU JTPF”) in 2009 and endorsed by the European Union Economic and Financial Affairs Council in May 2011 (the “EU Guidelines”). These guidelines present a simplified approach for analyzing and documenting low-value intra-group services. As such, they supplement the guidance on intra-group services and related examples set forth in Chapter VII of the Guidelines.

BIAC would encourage the OECD to review the recommendations made in the EU Guidelines as part of the Chapter IV project, not only with respect to low-value intra-group services transactions, but to other types of intercompany transactions as well. For purposes of this discussion, it is useful to divide these recommendations into two main areas: substantive transfer pricing issues and documentation requirements.

With respect to substantive transfer pricing issues, three general topics deserve attention:

i. **Foundational issues**: Basic definitions and concepts involved in intercompany transactions;

ii. **Compensation**: The determination of arm’s length mark-ups for intercompany transactions; and

iii. **Intangibles**: Embedded intangibles and other intangibles issues.

(i) **Foundational Issues**. Many of the controversies involving routine intra-group services transactions that are faced by BIAC members turn on such basic questions as whether an affiliate has derived a benefit from an activity performed by another affiliate, which costs are associated with that activity or service, and which key is appropriate for allocating such costs. While the answers to these questions depend upon the facts and circumstances surrounding the transactions at issue, a problem that BIAC’s members commonly face is that tax administrations differ in their interpretations of the provisions currently in the Guidelines that are relevant to these questions. More perniciously, tax administrations have been known to take positions on these issues that seem to be geared toward the maximization of adjustments rather than upon principled analyses and fair assessments of the reasonableness of global allocation policies.

These experiences indicate that more expansive guidance is sorely needed on these and other foundational issues than what is currently found in the Guidelines. In terms of the nature of this guidance, BIAC would prefer that it take two forms. First, it would be helpful for the OECD to identify the variety of services – administrative, finance and accounting, human resources, information technology, among others – that are so routine and widespread that tax administrations should generally confine their examinations of transactions involving these services to whether the taxpayer
has followed a non-discriminatory policy for allocating their costs.\footnote{The U.S. Internal Revenue Service has set forth such a list of routine services in Revenue Procedure 2007-13, 2007-1 C.B. 295.} In the absence of clear facts to the contrary, for example, taxpayers should not be forced to prove that such services provide benefits to their recipients.

Second, BIAC would urge the OECD include detailed examples together with guidance on broad principles. The purpose of such detailed examples would be to demonstrate and explain the application of the concepts and principles. Ideally, such examples would examine and identify differences in facts and circumstances that lead to differences in outcomes. For example, it would be useful for the Guidelines to start with an example in which a certain intra-group service does provide a benefit to an affiliate, and then to follow it with a related example (or examples) in which the opposite conclusion is reached because certain discrete facts have been changed. BIAC believes that this type of “compare-and-contrast” style of presentation, found to a certain extent in the examples at the end of Chapter IX, would be conducive to resolving the many transfer pricing controversies between taxpayers and tax authorities that boil down to basic, black-or-white differences about the application of fundamental concepts.

(ii) Compensation. BIAC recognizes that the facts and circumstances of any intercompany transaction must dictate the transfer pricing method to be applied and the selection of companies on the basis of which the related party will be tested. Nevertheless, BIAC believes that a great deal of transfer pricing practice and administration will be improved if the OECD identifies and endorses widely-followed “best practices” and widely-used quantitative benchmarks for routine transactions.

BIAC commends the EU JTPF’s explicit recognition that a mark-up range of 3% to 10% can serve as a reliable benchmark for intra-group non-core services transactions. Importantly, this range does not represent an “industry average”. Rather, it reflects the mark-ups that are consistent with the experience of both taxpayers and tax administrations in applying the arm’s length standard to tested parties that have function/asset/risk profiles comparable to those of uncontrolled companies that routinely appear in comparables sets developed by tax administrations and taxpayers.

When updating the Guidelines in the Chapter IV project, the OECD should seek out and take full advantage of such practical knowledge and experience of taxpayers and tax administrators. For example, the OECD might also encourage tax authorities to develop standardized profit mark-ups based upon the results of APAs and MAP proceedings. Although each APA and MAP case involves unique facts and circumstances, tax administrations with experienced APA and MAP programs will have entered into enough agreements and will have applied the arm’s length standard in a diverse enough number of cases to be in a position to disseminate information about recurring fact patterns and the profit mark-ups that they have accepted.

One issue in this area that requires particular attention is the (explicit or implicit) requirement held by some tax administrations that local-country companies be included in comparable sets. BIAC maintains
that this position is inconsistent with revised Chapters I through III of the Guidelines. Economic theory and practical experience suggests that there are a variety of services industries, generally involving certain manufacturing, distribution, research, and other activities, that are competitive and geographically mobile. As such, the economic returns earned by companies within these industries tend towards a competitive equilibrium that is consistent across different geographic regions. Accordingly, it is possible that reliable measures of arm’s length results can be obtained by reference to profit mark-ups on pan-regional sets of comparables. To insist that comparables sets be comprised of companies from a given jurisdiction is inconsistent with the evidence-based, reasoned approach underlying the “most appropriate method” standard. BIAC would ask the OECD to address this issue in the Chapter IV project, since it directly impacts multinational taxpayers who develop and seek to defend global transfer pricing policies that rely on pan-regional comparables sets. Indeed, this is consistent with the recommendation of the EU JTPF in its Code of Conduct on transfer pricing documentation for associated enterprises in the European Union (EUTPD): “Member States should evaluate domestic or non-domestic comparables with respect to the specific facts and circumstances of the case. For example, comparables found in pan-European databases should not be rejected automatically. The use of non-domestic comparables by itself should not subject the taxpayer to penalties for non-compliance.”

(iii) Intangibles. As indicated above, BIAC recognizes that “routine” intercompany transactions can (but in many cases do not) involve intangibles, such as those “embedded” in the transaction. BIAC would welcome the opportunity to consult with the OECD and other stakeholders about these issues in greater depth than can be explored here. As a prelude to such further discussions, however, BIAC offers the following brief observations.

There is an important category of intercompany transactions that may involve the presence of some intangible assets, but not the types of intangible assets that can be transferred or that are compensable if they are transferred. A closely-related category of transactions involves a compensable transfer of an intangible, but not a transfer that invalidates the application of a one-sided TNMM (i.e., does not require a profit split). For BIAC, neither of these transaction types involve intangibles that should mandate the use of a two-sided, profit-split method. BIAC believes this point must be emphasized in the context of the Chapter IV project, given the extent to which intangibles issues can complicate transfer pricing administration. For example, since the Guidelines were promulgated in 1995, tax administrations, taxpayers, and practitioners have come to understand that it is not unusual for participants in a given industry to possess processes, skills, capacities, and other “industry” intangibles that are similar to those possessed by other participants. Even so, it is not uncommon to find tax inspectors who instinctively apply a two-sided, profit-split method without considering whether it is the “most reliable” method, or whether it is possible to provide a return for routine services separate from an incremental additional profit as compensation for the use of an identifiable intangible.

Again, these are important and complicated issues. BIAC would thus welcome the opportunity to work with the OECD and other stakeholders to develop practical guidance in this area.

C. **Comments on Documentation**
BIAC’s members do not disagree with the need to prepare transfer pricing documentation. However, the costs they incur in preparing documentation packages on a global scale can be staggering, often rising into the millions of dollars. What is difficult for BIAC’s members to accept is that their good faith efforts to develop robust documentation might be cast aside by tax administrations because it is not sufficiently tailored to include the exact content or follow the exact form required by individual countries’ rules.

BIAC’s members believe that such insistence on precise content and format is inconsistent with language currently in Chapter V of the Guidelines, which underscores the importance of finding a “balance” between the needs of tax administrations to receive thorough and informative documentation and the administrative costs and burdens the preparation of such documentation places on taxpayers. Perhaps as a way to reinforce this existing guidance, the OECD could identify in some detail the content that it believes should be included in a “best practices” documentation package. While such guidance should not be prescriptive, it could set a standard to which taxpayers should aspire and, accordingly, which tax administrations should accept when it is met. In this regard, in the interest of international consistency, BIAC would like to suggest that the OECD refer to the EU Code of Conduct on Transfer pricing documentation (Resolution 2006/C 176/01), and in particular Section 1, paragraphs 4 and 5, to ensure that the guidance it gives on documentation is aligned with the EU’s guidance as far as is practical.

Along these lines, BIAC hopes that the Chapter IV project will address issues surrounding global transfer pricing documentation packages, which are prepared to cover transactions with underlying economic characteristics that are relatively stable over time. Given the nature of these transactions, and given the effort involved in preparing such documentation, the OECD should identify “best practices” that will give multinational taxpayers a measure of confidence that documentation having a certain content will be acceptable on a broad scale. The basis for this proposal once again stems from the experience that tax authorities and taxpayers have developed over time in applying the arm’s length standard. While the conceptual unit of transfer pricing examination and review will always be the individual transaction with its unique facts and circumstances, BIAC hopes that the OECD will nevertheless explicitly recognize that considerations of administrative efficiency suggest that broader, aggregate approaches to transfer pricing documentation and compliance are acceptable in a majority of cases.

D. Comments on Safe Harbours

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Paragraph 5.6, for example, reads in part, “When requesting submission of . . . documents [that would not otherwise be prepared during the normal course of business, absent their need to be prepared for tax], the tax administration should take great care to balance its need for the documents against the cost and administrative burden to the taxpayer of creating them.” Similarly, paragraph 5.7 states that taxpayers “should not be expected to have prepared or obtained documents beyond the minimum needed to make a reasonable assessment of whether it has complied with the arm’s length principle.”
BIAC believes that it would be appropriate to reorient the section of the Guidelines on safe harbours. Rather than focusing on the “fundamental problems” of safe harbours as they currently do, the Guidelines should instead promote safe harbours as a useful tool through which desirable aims of administrative simplification can be achieved. The experience that tax administrations and taxpayers have gained in applying the arm’s length standard over time can be drawn upon to develop informed and judicious safe harbour provisions. The Guidelines should offer ideas and considerations that would aid in the development of such provisions.

Although the OECD’s recently released multi-country survey of existing transfer pricing simplification measures suggest some degree of comfort with safe harbour provisions among its members, BIAC recognizes that this would be a significant change in the OECD’s position, and that such a shift would implicate longstanding concerns about the abuses to which safe harbour provisions (especially elective provisions) are vulnerable. However, BIAC believes that many “routine”, limited risk distribution, contract manufacturing, or services transactions are generally not abusive and, as such, would be suitable for safe harbour treatment. Undoubtedly, there is no way that the possibility of abuse can be removed entirely. However, the case for safe harbours should be made from the standpoint of “mainstream” cases, where the benefits of administrative simplicity and efficiency seem to clearly outweigh the costs of possible abuse. Given the administrative burden on taxpayers to comply with the arm’s length principle, it may be practical to provide safe harbours on small transactions or transactions entered into by small taxpayers.

In this vein, contrary to the suggestion currently in the Guidelines that safe harbours are “arbitrary” at best, BIAC believes that it is entirely possible to develop safe harbour provisions that are compatible with the arm’s length standard. As has been noted, the determination and application of the “most appropriate” transfer pricing method and the selection of comparables and adjustments of financial data are familiar to most tax administrations and taxpayers. This shared experience could be incorporated into safe harbour provisions that provide reliable measures of arm’s length results.

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3 In its comments to the OECD on the TNMM project, BIAC made a similar recommendation along this line: “Lastly, BIAC suggests that it may be appropriate to reconsider the ‘safe harbour’ prohibitions which were included in the 1995 Guidelines, given that experience suggests that perceptions exist of ‘reasonable’ margins or mark-ups” (pg. 17).

4 “Multi-Country Analysis of Existing Transfer Pricing Simplification Measures” (released 10 June 2011)

5 Paragraph 4.106.

6 U.S. commentator Patricia Lewis has recently offered such a proposal for safe harbour rules that would apply to “small” taxpayers and “small” transactions, where eligibility would be measured by reference to objective characteristics, such as assets or sales. “Short Cuts for Small Fry: Why the IRS Should Reconsider Transfer Pricing Safe Harbors for Small Taxpayers, Transactions”, BNA Transfer Pricing Report, 21 April 2011. Her proposal recommends types of transactions to which the safe harbour would be applied and appropriate profit level indicators and sources of quantitative benchmarks. She also identifies certain restrictions on its use, such that it be maintained for a certain period of time if it is elected by a taxpayer and that it be subject to anti-abuse restrictions. BIAC commends Ms. Lewis’s discussion to the OECD as a useful model for approaching the task of restructuring the Guidance on safe harbours in Chapter IV.
BIAC has concerns that a taxpayer adopting a safe harbour in one country should not seek remedy through mutual agreement procedures when it faces a double tax due to challenges in the other jurisdiction. We would like the committee to revisit this point under the new project to see whether we could reconsider to have a mechanism in the following manner: (i) a local safe harbour rule is respected in the jurisdiction, thereby achieving simplification in the jurisdiction; however (ii) if the tax authority in the other jurisdiction finds the result is inconsistent with the arm’s length principle, the OECD guidelines recognize that it may make an adjustment accordingly; then (iii) the taxpayer may choose to seek relief through the mutual agreement procedure under Article 25 of the OECD Model Treaty, where the two tax authorities resolve the matter based on the arm’s length principle without referring to the safe harbour rule; and (iv) the jurisdiction with the safe harbour rule should provide taxpayers with a mechanism for double taxation relief through competent authority negotiations based on the arm’s length principle, as well as through arbitration, regardless whether a taxpayer has initially chosen to apply the safe harbour rule or the arm’s length principle.

E. Comments on Serious Penalties

BIAC believes that it would be useful to clarify what a serious penalty may be:

- In particular, since national legislations set forth different definitions of “penalty” and “serious penalty”, it is important to specify in which cases and under which circumstances a penalty may be considered “serious” for transfer pricing purposes. The identification of a “serious penalty” may have an impact on the legal and administrative proceedings regarding transfer pricing. A “serious penalty”, for example, could prevent taxpayers from benefiting from certain simplified administrative measures;

- A common definition of “serious penalty” may be required. Since each country provides its own definition of “serious penalty” (see, for example, the Individual Declarations of the Contracting States on Article 8 of the EU Arbitration Convention), a common definition of “serious penalty” would prevent taxpayers from being disadvantaged from the different applicable national definitions. To this purpose, a “serious penalty”, for example, may be a penalty for a severe tax infringement as well as a criminal penalty.

IV. Comments on APAs and MAP Procedures

BIAC would also like to offer certain comments on APAs and MAP procedures. The potential that APAs have for reducing controversies and minimizing audit and compliance costs are well recognized by taxpayers and tax authorities, as evidenced by the proliferation of APA programs around the world over the course of the last twenty years. While APAs still remain generally attractive, it has been the experience of some BIAC members that their benefits may no longer outweigh their costs, or at least not outweigh them as much as they have in the past. The concerns that taxpayers have with APA programs are no doubt familiar to the OECD. The sheer length of time that it takes to complete an APA, which can
reach upwards of three to five years depending upon the jurisdiction, is daunting, as are the administrative costs that can be involved (in terms of hours spent responding to tax authority queries and information requests and generally overseeing the application). Of course, BIAC recognizes that these problems arise in no small part because of the crippling funding and staffing shortages that tax authorities currently face. But given that such shortages are unlikely to be remedied in the near term, BIAC believes that it would be useful for the OECD to examine aspects of APA and related MAP processes in order to make them as efficient and effective as possible within the constraints they face. In this regard, BIAC offers the following comments:

- First, bilateral or multilateral APAs have seemingly become a practical necessity in order to obtain some certainty with regard to intra-group services. This is because multinational taxpayers do not have confidence that the provisions of their global intra-group services policies will be respected, as discussed above. Thus, in order to achieve certainty over transfer pricing issues, taxpayers naturally look to APA programs. In light of the funding and staffing challenges that some tax authorities face, it is important that the OECD develop robust guidance and apply the full weight of the OECD’s authority to recommend improvements to these programs, especially so that they are able to handle the volume of cases involving routine intra-group services transactions. One practical way in which the OECD might promote these administrative efficiencies on a broad scale would be to recommend that member countries with APA programs publish non-taxpayer specific annual reports that offer specific details of the results of their APA programs, such as number of APAs, types of transactions covered, types (and number) of transfer pricing methods used, and so on. In this vein, the OECD should also recommend that its members work toward agreeing on common APA and MAP documentation and processing guidelines, perhaps similar to the operational guidance agreed to by members of the Pacific Association of Tax Administrators in 2004.

- Second, the Guidelines currently recommend that “an APA should be concluded on a bilateral or multilateral basis between competent authorities through the mutual agreement procedure of the relevant treaty” wherever it is possible to do so. Some BIAC members, however, have been successful in stringing together networks of unilateral APAs to cover transactions with affiliates performing similar functions, employing similar assets, and incurring similar risks. These APAs are separately negotiated, usually with tax administrations having significant transfer pricing experience or those that assume leadership roles in transfer pricing matters for given regions. The provisions of these unilateral APAs are then applied to transactions involving countries where an APA is not pursued. BIAC believes that this approach has certain merits that are worthy of the OECD’s consideration. In particular, this approach helps avoid duplication of due

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7 See Molly Moses, “Netherlands: Netherlands in 2010 Completes 205 APAs, Grants 355 ATRs, Exceeding 2009 Totals”, BNA Transfer Pricing Report, 3 June 2011 (reporting on an analysis prepared by KPMG Meijburg of 2010 statistics indicating that APAs took 47 days on average to process and that cross-border APAs generally took 18 months to complete in the Netherlands).

8 Paragraph 4.162.
diligence and analytical effort that would otherwise arise if every tax administration were to start from scratch in reviewing these similar transactions that have already been scrutinized by other tax administrations. It would seem that this approach thus promotes the goal of administrative efficiency sought with the Chapter IV project.

• Third, on the topic of unilateral APAs, tax administrations have been known to apply different standards and transfer pricing methods to unilateral APAs and bilateral APAs. The standards that have been applied to unilateral APAs have also been known to differ depending upon whether they involve inbound or outbound transactions. These practices are inconsistent with basic tenets of the Guidelines. Accordingly, BIAC requests that, if nothing else, the OECD encourage member countries to adopt consistent transfer pricing policies and methods for unilateral and bilateral APAs.

• Fourth, in terms of ways to improve the efficiency of APA programs, BIAC recommends that the OECD underscore language found at paragraph 5.155 of the Guidelines, which reads in relevant part, “Tax administrations should . . . seek to ensure that APA procedures are not unnecessarily cumbersome and that they do not make more demand of taxpayers than are strictly required by the scope of the APA application.” Specifically, not all APA or MAP requests are alike, and thus not all requests demand the same degree of scrutiny and attention. Some requests are straightforward, i.e., the covered transactions and other salient facts and the proposed transfer pricing methodology are relatively straightforward or the values involved are relatively small. Alternatively, some requests involve transactions or facts that are more complex and thus require more time and resources, such as transfers of high-value intangibles. Procedures for handling APAs and MAP cases should recognize these differences and find ways to improve intake and review practices. Country peer reviews may also be helpful in examining whether such policies are followed.

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Thank you again for the opportunity to comment on this important project. We would welcome further consultation on the project, and would be pleased to receive any questions that you may have on our submission.

Sincerely,

Chris Lenon
Chairman
BIAC Committee on Taxation and Fiscal Affairs