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EL PUNTO DE VISTA DE LAS EMPRESAS TRANSNACIONALES ACERCA DEL RECIENTE DOCUMENTO DE LA OECD: "TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS — DISCUSSION DRAFT OF PART I"/*

Adrian J.M. Timmermans

*/Este documento fue elaborado por el señor Adrian J.M. Timmermans, Miembro del Comité de Impuestos de la Camara Internacional de Comercio con sede en Paris, y Director de Asuntos Fiscales de la Federación de Industrias de Holanda (UNO) con sede en La Haya. Las opiniones expresadas en este trabajo, el cual no ha sido sometido a revisión editorial, son de la exclusiva responsabilidad del autor y pueden no coincidir con las de la Organización.

Speech for the VII Seminario Regional De Politica Fiscal on January 23rd -26th, 1995 in Santiago, Chile.[1]

Ladies and Gentlemen,

To day I would like to address an issue that is currently receiving a lot of attention from all over the world. "Transfer pricing". However, before starting with the subject, I think I should apologize for not addressing you in Spanish. The reason for not speaking Spanish is taxation. Some 425 years ago the Netherlands was ruled by the Spanish Empire. Everybody learned Spanish at school. Then the Duke of Alva, who ruled the Netherlands on behalf of the King of Spain, raised the taxes. Immediately the people revolted. In an eighty-years war the Spanish were thrown out of the Netherlands[2]. One of the results being that I am unable to speak Spanish.

International trade has existed for thousands of years. By the 14th century the Venetian traders used sophisticated monetary techniques to facilitate their import and export business. They were expert at using contacts and associates in third countries through which to route various types of transactions. Little changed in actual techniques over the following four hundred years, although the volume of international trade and range of goods increased. Famous international trading companies were established, including the Dutch East India Company in 1605, followed by the English Hudsons Bay Company in 1670 and East India Company in 1698. By the end of the 19th century it was not uncommon for powerful industrial companies requiring, say, rubber from Indonesia, to own and run a rubber plantation there rather than rely on imports from a local independent company. The forerunners of today's multinational companies were in place. However, the actual transactions could be identified as import and export of materials or finished products. Because communications between countries took weeks, if not months, services and management expertise were supplied on site.

It was not until the early 20th century that the developments occurred which would trigger the move towards what is now termed a global economy. The expression describing the integration of the world economy. The combinations of technological advances and speed as well as reliability in communications and transport made a new approach in international business activity possible. For example, technology continued to supplant skilled labour. Ease of communication, together which cost-effective transport and storage, meant that manufacturing functions could easily be split and cheap unskilled labour in the Far East used effectively. Also, specialist functions could be centralized in one country. The operational blueprint of a multinational company has changed beyond recognition from the international business blueprint of the early 20th century. Certain

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[1] Adrian J.M. Timmermans, Director Fiscal Affairs, Federation of Netherlands Industry (VNO)

[2] Ferdinand H.M. Grapperhaus, Alva en de tiende penning, Walburg Pers, 1982

industries such as motor cars, electronics and pharmaceuticals are dominated by multinational companies.

The change did not happen overnight; it took nearly three quarters of a century for the global economy to emerge to a notable degree. By the 1990s there are three discernable aspects of a global economy. First, the demise of the national product. Second, the centralization of services and functions such as treasury, marketing, and research and development. Third, the opportunity for global trading[3].

"Globalisation". As a slogan, globalisation is the stalest of buns. Lenin made a living complaining about it a century ago. In the 1960s every American firm worth its salt talked about being a "multinational". In the 1980s "globalisation" was a buzzword that launched a thousand strategies. For years, management gurus have pontificated on "the borderless corporation". Yet today's globalised firms are much more significant than their predecessors.

There are so many of them! The number of "transnational corporations" in the world's 14 richest countries has more than tripled in the past 25 years, from 7,000 in 1969 to 24,000 today. The world now boasts a total of 37,000 transnational companies, which control about a third of all private-sector assets. They enjoy worldwide sales of about $5.5 trillion; slightly less than America's GDP in 1993. American firms' revenues from manufacturing abroad are now twice their export earnings[4].

Globalisation has put much more emphasis on the subject of my speech. Transfer pricing has become a much more important issue than a few decades ago.

The focus of my remarks today will be an OECD document entitled: "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations - Discussion Draft of Part I". Published in July, 1994. It is the first part of a complete revision and merger of the OECD's 1979 and 1984 Transfer Pricing Guidelines. The OECD is currently considering public comments submitted on the report, and intends to finalize this portion of the report in June this year. Subsequent portions of the report will cover a number of additional subjects relevant to transfer pricing: penalties, documentation, cost-sharing, and corresponding adjustments. To date only Part I of the Guidelines has been published as a discussion draft.

Transfer pricing has always been a very important subject. It attracts a great deal of scrutiny from legislators, tax administrations and taxpayers.
Understandably, each tax administration wishes to ensure that it subjects the

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[3] Jill C. Pagan and J. Scott Wilkie, Transfer Pricing strategy in a global economy, IBFD 1993

[4] The Economist, July 30th-August 5th 1994

correct amount of income to tax. But also, and as understandably, taxpayers need to ensure that the same amount is not taxed twice. The subject has drawn even more attention in recent years. I think that this sharper focus is mainly attributable to two causes.

One cause is the increasing pressure to raise revenue from foreign owned enterprises in especially the United States[5]. The second cause is the fact that in the opinion of the United States legislature the system of transfer pricing has not been working as well as they expect it to do. Leslie B. Samuels, assistant Secretary for Tax Policy in the United States said in a speech at the annual International Tax Institute meeting, that the system does not work as well as it should.

From the US-government's perspective, he saw two obvious flaws. First, there is insufficient self-compliance by taxpayers. Second, the legal framework does not offer taxpayers, tax administrators and courts adequate guidance in cases in which the traditional transfer pricing methods are inadequate[6].

The notion that the US government does not get its so-called "fair share" when income is allocated among tax jurisdictions has led to an increasing number of changes in the US tax legislation. In the past few years tax legislation and implementing regulations have been introduced which have met with critical reactions from governments and the EU-Commission as well as from the international business community. This criticism is based on the conviction that to some extent the newly introduced rules discriminate against foreign owned US operations. The rules also deviate from generally accepted international tax standards laid down in the 1979 OECD report on Transfer Pricing. A prime example is the application of income-based methods rather than transactions-based methods for determining the proper level of transfer pricing. Another one is the adjustment of previous years' taxable income based on facts which could not have been known at the time when the intercompany transaction took place.

The harm which one-sided actions may cause to international trade can hardly be overemphasized. It is of the utmost importance that there exists consensus on the interpretation of the arm's length standard, the principle which is embodied in many tax treaties and in the OECD and UN model treaties. The principle which provides a compromise between the substantive rules of different countries. Common guidelines permit the competent authorities to resolve disputes on transfer pricing and so contribute to the avoidance of international double taxation.

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[5] President Clinton campaigned on a promise to collect $ 45 billion in extra tax revenue by cracking down on non-US companies using transfer pricing to shift income out of the USA

[6] Department of the Treasury News, December 16, 1994

As a member of the Tax Committee of the International Chamber of Commerce, and possibly even more as a representative of the Dutch industry, I would like to stress that bilateral tax treaties are of great importance for industry. Those treaties provide the means to avoid international double taxation. If enterprises can be confident that tax authorities can reach consensus on the arm's length principle, enterprises can do their business without being confronted with international double taxation. Of course, obligatory arbitration, as is now in force between the countries of the European Union would guarantee that transfer pricing disputes can no longer result in international double taxation.

Enterprises are strongly involved in the globalisation of business. ICC regards the development of international trade and investment as of the utmost importance. Such trade and investment cannot prosper without a stable framework of fiscal order based on international principles accepted as widely as possible.

In this context ICC regards the work previously done by the OECD on transfer pricing as invaluable. Invaluable in the sense that it sets out the ground rules for both business and tax authorities when assessing the outcome of business activities and thus provides the certainty which is conducive to commercial decision making and risk-taking.

It is therefore right and proper that OECD should consider the continued validity of its 1979 views in the light of particularly the globalisation of market-places. It is reassuring to learn from the Discussion Draft Part I that the arm's length principle underlying the 1979 Report has stood the test of time and that refinements are required only at the margins.

ICC also strongly supports' the robust rejection by the Discussion Draft Part I of other approaches to the taxation of cross-border activities, particularly worldwide combined-reporting unitary taxation. The problems with unitary taxation were very accurately identified in 1979. Unitary taxation has caused very much international contention in recent years.

The significance of the arm's length principle goes well beyond relationships between OECD member states: it is embodied in the United Nations model tax treaty and has been adopted in many tax treaties to which non OECD members are (one of the) parties. No alternative approach to transfer pricing is conceivable which may count on a comparable degree of international acceptance.

The Discussion Draft does, however, give ICC cause for concern. The principal issue, discussed at some length below, is that of profit comparison. ICC absolutely rejects the notion that profit comparison is an arm's length method and insists that it can only serve as an internal administrative test and not as the basis for determining adjustments. Treating profit comparison as a method for determining transfer prices would be a grave distortion of the arm's length principle.

Profit comparison and profit split as possible approaches for setting transfer pricing disputes have drawn attention in recent years because temporary and proposed Regulations in the United States describe them as methods for determining arm's length prices under the transfer pricing section (S. 482) of the US Internal Revenue Code.

In the discussion on how to determine arm's length prices, the subject of profit methods is not new. Generally profit methods are not regarded with favour. The 1979 report of OECD clearly rejects "direct methods of profit allocation" and "fixing transfer prices by reference to predetermined formulae" (paragraph 114). It regards profit comparison "normally... only as pointers to further investigation" (paragraph 71). It considers comparing yield or return on capital invested with yield or return from investing the capital in other ways as arbitrary and generally not practicable (paragraphs 73 & 74).

In recent years, however, "profit comparison" and, less so "profit split" have acquired notoriety by reason of their appearance in US proposed intercompany transfer pricing regulations issued in January 1992 and January 1993 and, in the case of profit comparison, in US temporary regulations issued in January 1993 and in the new regulations issued in July, 1994.

Although the application of profit comparison will be complicated and difficult, the underlying concept is deceptively simple. The process starts by selecting independent enterprises performing functions which are comparable to those of the taxpayer being investigated. Measures of profitability of the independent enterprises are then established. Such measures may be one or more of return on assets, ratios of income to sales or to costs, etc. Working back to the taxpayers assets, sales, costs, etc., "comparable profits" are calculated on the basis of these measures. If this leads to a range of comparable profits, the relevant interval within that range must be determined by means of statistical techniques. If then the actual profit of the taxpayer is not within the relevant interval, the prices for transactions with associated enterprises must be adjusted so as to result in a profit equal to the midpoint, or its statistical equivalent, of such interval.

If profit comparison were applied in practice there would be serious complications. All the steps described above would require the collection of large quantities of quite detailed, and mainly confidential information. Furthermore, the nature of the profit comparison process is that it focuses on circumstances in the country of one taxpayer. This is unlikely to result in successful corresponding adjustment discussions with the other country involved. These aspects are discussed in some more detail below.

Profit split is entirely different form profit comparison. It looks at the actual profit or loss from a transaction or series of transactions between two or more associated enterprises and then divides such profit or loss over the individual enterprises. The split may be applied to the total combined profit of the associated enterprises from such transactions but can also be restricted to the part of the combined profit which is felt to represent profit from intangibles. The basis for the split will be a measure of the role each of the associated enterprises plays in the generation of the profit.

Functional analysis would be applied to determine the relative value of the relevant activities of each of the enterprises. An attempt would be made to approximate the division of profits that independent enterprises would have expected.

It is the view of ICC that, although profit split is not found in the market place, it can in fact prove useful in special circumstances. However, it is not appropriate for general application as a method on a equal footing with the transaction based methods ("Comparable Uncontrolled Price (CUP)", "resale" and "cost plus").

The arm's length principle remains the touchstone

For many decades it has been internationally accepted that there is only one criterion for examining transfer prices between associated enterprises. This is the arm's length principle laid down in article 9 of the OECD model and in the same article of the 1980 UN model.

Underlying the Draft Discussion Part I and the 1979 Report is the market based approach. Taxation of cross-border activities by different OECD taxing authorities is founded on the integrity of transactions entered into by unrelated parties (independent enterprises). The arm's length principle replicates this in relation to related party transactions by

a) accepting as valid inter-affiliate transactions which correspond to unrelated party transactions and
b) rewriting the prices and terms of such transactions which do not so correspond, to the extent necessary to make them correspond but no further.

In carrying out this process of evaluation of related party transactions and, where necessary, their modification, a number of key factors apply. These were identified in the 1979 Report and are carried over into the Discussion Draft Part I.

Both the Discussion Draft (paragraph 52) and the 1979 Report (paragraph 15) state that the enquiry into the acceptability (for tax purposes) of a controlled transaction must begin with the actual transaction and not with some hypothetical alternative transaction which could have been entered into.

It follows from this that in comparing the actual transaction with what unrelated parties would have done the analysis must be based on the facts and circumstances which existed at the time the transaction was actually entered into and not on ex post facto information or judgment.

The arm's length principle provides for the adjustment of prices between associated enterprises to the extent that they differ from those that would have been agreed between independent enterprises. Of course, the final consequence of such adjustment is the adjustment of taxable profit (cf. article 9 OECD model). However, it should be emphasised here that the profit adjustment takes place only as a consequence of comparison of prices (or "conditions" in the words of art. 9). This principle has proved to be of signal importance in the removing of obstacles to the growth of international trade and investment. There is simply no alternative available that would be anywhere near as effective or could count on international acceptance.

The essence of the free market is that there always will be winners and losers. Unrelated parties enter into different agreements with each other even where the same items - goods, services, intangibles - are involved. As a result not only will there be a range of market terms and conditions but each of the parties to the transactions will stand to gain or lose more or less than others, depending on what is acceptable for them in their particular deal. Equally even where such unrelated parties enter into two or more identical agreements all the other factors in the internal economic make-up of the taxpayer, and external factors such as exchange rate movements, acts of God, wars and marketing success, will determine whether each makes an ultimate profit or loss and the amount of either.

The Discussion Draft thus rightly recognises (paragraph 61) that there can be a range of equally valid terms and conditions which are all properly arm's length. The transactions of connected parties therefore need to be judged on a correspondingly flexible basis.

Given that there is such a range ICC does not think that a great deal of time and effort should be expended by taxing authorities or imposed on business in pursuit of identification of some supposedly "ideal" point in any such range. If the taxpayer can demonstrate that he is within an arm's length range that should be sufficient. There should be no further burden of proof put on the taxpayer than to demonstrate that he is within the appropriate arm's length range.

Nobody should expect business people involved in transfer pricing to undertake complex transfer pricing studies including the comparable profit "method" or profit split "method" and the available data related thereto, before deciding on the terms of the contract and on the choice of arm's length method to be used for veryfying the arm's length nature of such contract. Business people have to make a business decision and then to carry it out correctly, using their own judgment based on comparable data as far as such data are available to them. It is not their job to spend their time on internal discussions on tax theory. They should take care of their business in the market.

In this context, ICC gratefully notes OECD's statement that transfer pricing is not an exact science. This sentence should become a headline of this Discussion Draft, demanding tax auditors to stay away from exaggerated scrutiny.

What is clear from the 1979 Report and has been accepted throughout the international network of tax treaties is that it is by examination and appropriate adjustment of connected party transaction terms to arm's length terms that the taxpayer's tax results (profits or losses) are determined. Such examination may equally lead to no adjustments, as the OECD and national tax authorities have always recognised.

I should leave no doubt in your minds that ICC regards the preservation and continued application of the arm's length principle to be vitally important. Any method or procedure for adjusting transfer prices must conform with this principle. If it does not, or to the extent that it does not, such method or procedure is in conflict with internationally accepted principles and may not be imposed on taxpayers.

I would like to analyze profit comparison and profit split primarily in the light of three essential aspects of the arm's length principle and its application. These are:

- prices for transactions between associated enterprises should be, for tax purposes, those that would have been agreed between unrelated parties for the same or similar transactions in the same or similar circumstances;
- the arm's length principle allows a common approach by the tax authorities involved in a transfer pricing situation and so contributes to the avoidance of double taxation;
- the information required should be equally available to both tax authorities and taxpayers; the effort required to determine the transfer price must be reasonable and commensurate with the relative importance of a possible adjustment and it should be feasible at the time of entering into the transaction with an associated enterprise to set a transfer price which complies with the arm's length principle.

Profit comparison cannot be an arm's length method

There is a fundamental reason why the principle for testing and adjusting transfer prices is based on price comparison and not on profit comparison. In order to establish which conditions would apply between independent enterprises, one must look at the meeting place of such independent enterprises, which is the market. Prices in the market are established by supply and demand and not by the profitability of the participants. Of course, in the longer term, an efficient market for any product or service should only exist if some buyers and some sellers can expect a profit, but individual buyers and sellers will have widely varying profit experiences. There are too many examples of great successes and abysmal failures occurring in the same narrow market sector.

If it were possible to look at the profit of an enterprise dealing with associated enterprises and come up with relevant information for adjusting transfer prices then it should be equally possible to start from market prices and produce a generally valid forecast of the profits of independent enterprises active in the market concerned. And that, obviously, is not the case.

Just as prices in the market are not determined by profits, profit levels of market participants do not depend exclusively on market prices for goods or services. The relative profit of a particular enterprise may be high or low when compared to that of its competitors because of differences in such profit affecting factors as e.g. level of utilisation of machinery and work force, efficiency of operations, quality of management, market acceptance of products, presence of start up costs, quality (skills, education) and cost of workforce, degree of automation, overhead sharing by other processes, effectiveness of advertising etc. This immediately demonstrates the absolute impracticability of an attempt to derive from competitors' profits conclusions that will be relevant to a particular associated enterprise. Each and every one of the factors which may contribute to relative differences in profits will have to be analyzed and its effect quantified before a comparison can have any relevance. Such analysis is beyond the powers of most taxpayers and cannot be achieved in practice. Without such analysis profit comparison cannot yield any information of relevance to a transfer pricing discussion other, possibly than an indication that the result of applying the appropriate methods should be verified.

Quite apart from the analysis of the factors affecting the profit, it would be necessary to apply an extensive functional analysis of the enterprises to be compared in order to establish the basis for comparability.

The profit comparison approach is based on a seriously flawed view of the justification for adjusting the profit of taxpayers who engage in transactions with associated enterprises. It is internationally accepted that adjustment is only called for and justified if and to the extent that prices differ from what they would have been if the parties to the transaction had not been associated but all other circumstances had been exactly the same.

Profit comparison, however, by effectively establishing a **normative** profit, goes beyond a correction for the effect of the association. Profit comparison seeks to tax a profit that might not have been made whether or not the parties to the transaction were associated. In fact, the tax authority which adjusts profits on the basis of profit comparison may take the view that better commercial decisions should have been taken by the taxpayers. This goes against the universally accepted principle that tax should be applied to the result of commercial activities and not to the hypothetical result if the tax inspector (mostly, ex post) had taken the commercial decisions. In other words, the tax inspector should not sit behind the desk of the entrepreneur and ask himself which commercial decisions he would have made differently if he had been the entrepreneur.

Another fundamental defect of profit comparison is its one-sided application. If the countries of residence of two associated enterprises each propose transfer pricing adjustments based on applying profit comparison, then it will be a rare event indeed that these proposals converge, let alone match. The likely outcome is a significant gap between the two proposals and the method itself provides no clues as to how to close that gap in competent authority proceedings. This problem arises because the competent authorities discussion should focus on the transaction between the associated enterprises whilst profit comparison makes each of the competent authorities look away from the transaction. There is, of course, no good argument why the competent authority of one country should go along with the profit comparison applied by the authority of the other country. It may well stick to its own analysis and ignore the effects of the resulting adjustment on the relative profit of its resident taxpayer. Thus the application of profit comparison significantly increases the risk of international double taxation.

As will be apparent from the foregoing, the taxpayer would need an inordinate amount of information to apply profit comparison. The major part of this would be confidential information concerning competitors. Obviously such information will not be available to the taxpayer, neither at the time of entering into the transactions with affiliates nor at any time thereafter. It is therefore not only impossible to apply profit comparison when transacting business with associated enterprises, but it is equally impossible to file tax returns on the basis of profit comparison or to defend in litigation against the application of profit comparison by the tax authorities.

Taxpayer access to the relevant information could only be achieved by forcing all enterprises to place much confidential and commercially secret information in the public domain. Such an invasion of the privacy of enterprises would be unwarranted

ICC is quite concerned about the way profit comparison is dealt with in the Discussion Draft. The 1979 Report explains quite firmly that profit approaches were not consistent with the arm's length principle. In paragraph 14 it says that "the use of such alternatives (e.g. profit comparison) to the arm's length principle is **incompatible** in fact with the articles 7 and 9 of the OECD Model Double Taxation Convention". In paragraph 71 it is mentioned that "Profit comparison may be helpful nevertheless to make comparison of this sort in relation to the gross profits from sales of particular products or groups but **even so the results of the comparison could normally be regarded only as pointers to further investigation.**"

By contrast, and whilst highlighting the many negative characteristics of profit comparison, the new draft presents the comparable profits method as a valid method for determining prices under the arm's length standard consistent with Article 9 (1) of the Model Treaty, however, only as a method of last resort.

Discussion Draft does not explain what objective changes have occurred since 1979 which, in the view of the OECD, justify this different conclusion.

I would like to conclude on profit comparison as follows:

Profit comparison has no validity as a method for determining inter-affiliate prices under the arm's length standard. This remains the ICC view for a number of compelling reasons for example:

a. Prices - and other contractual terms - are only one of any number of factors which determine a company's profitability (see, for example, paragraph 164 of the draft). The relative profitability of different companies thus offers no basis - whether conceptually or as a practical matter - for measuring the extent to which the terms on which a company has entered into related-party transactions deviate from arm's length terms.

b. The draft itself draws attention to the one-sided character of profit comparison. If a two-sided comparison were attempted it is inevitable that the parallel comparisons in the two countries would give entirely different results. It is difficult to envisage in such a situation any practicable approach which would enable the tax authorities involved to reach a mutual agreement. Double taxation would be the inevitable consequence.

c. Profit comparison, effectively by definition, appears bound to lead to the taxation of fictitious profits, that is profits which do not exist anywhere in the group to which the taxpayer belongs.

d. Application of the comparable profits approach depends on the availability to the taxpayer, contemporaneously, of voluminous and detailed information about comparable competitor companies. This information would not be available to the taxpayer.

e. Perhaps most fundamentally, profit comparison has no basis in business practice. It is not a methodology which companies would or - as a practical matter - could possibly use as a basis for setting prices in the ordinary course of their business. It thus fails to meet perhaps the most basic of the criteria to be examined in considering the validity of any given methodology in the context of the arm's length standard.

In brief, ICC continues to believe strongly that profit comparison is not an arm's length method, and that its proper role is as a pointer, in certain cases, to the need for further investigation, as stated in the 1979 Report.

Profit split

It is important to be clear that profit split - that is division of real results - is essentially different from profit comparison which imputes hypothetical normative profits. Profit split (equally loss split) has regard to real results. Normative profit comparisons could lead to imputation of a profit where in reality there was a loss - one of the key reasons for the OECD's rejection of formulary apportionment.

Profit (loss) split, as a last resort approach, does at least start from a real result by determining how a real cake should be divided. Normative profit comparison bakes its own hypothetical cake - or however many different cakes different fiscal authorities deem to be their own subjective norm.

In this sense profit split can be regarded as a transaction- based approach. Nevertheless, independent enterprises will not normally agree, after the fact, on prices for transactions based on splitting of the combined profit on the transactions. For this reason classifying profit split as an arm's length method which is capable of general application is not acceptable. The OECD recognized that. Therefore, this method is only applicable as a method of last resort.

There are circumstances, however, in which a profit split approach may help solve problems, such as competent authority proceedings or advance pricing agreement negotiations. Profit split can produce a result acceptable to the parties within the arm's length principle. Profit split may also be the basis for a voluntary agreement between tax authorities and taxpayer to settle an issue that has arisen on audit or in advance.

Documentation

ICC recognises the right and the duty of tax authorities to question the appropriateness of transactions between related parties. ICC also recognises that taxpayers have parallel obligations to abide by the arm's length principle and to provide authorities with the information which is pertinent to and necessary for specific cases. In this regard, ICC fully agrees that maintenance of contemporaneous documentation is in the taxpayer's own interest.

ICC believes experience shows that an increase in the amount of information required, and more particularly, information which is unrelated to the transactions and parties concerned does not contribute to a resolution of problems, but instead confuses matters further. By setting unreasonable and intolerable requirements for the maintenance and production of documentation, authorities can create an environment of resistance, controversy and mistrust with adverse effects on relations between authorities and taxpayers.

Multinational enterprises are involved in a huge volume of various kinds of international transactions on a daily basis, not only among affiliates but also with unrelated companies. It is nearly impossible to analyze comparables of and document every transaction. Moreover, it is certainly unfair to expect multinational taxpayers with related-party transactions to provide huge amounts of documentation when their independent competitors are not faced with such burdens. Requiring this amount of documentation will result in a regulatory barrier to international trade. Moreover, as clearly stated in the commentary to Article 9, authorities should not re-write the accounts of associated enterprises if the transactions have taken place on an arm's length basis.

ICC would like to suggest that a taxpayer must keep books and documentation as required by civil law. He must be able to demonstrate that the facts and figures reported in the books give a true and complete picture of the company's economic situation and of its business activity. Taxpayers must (and actually do) expect that their transfer prices as well as any other element of their accounts, could be questioned by tax authorities. The documentation established and maintained in the normal course of business will thus allow support for positions taken if the required information for applying an acceptable transfer pricing method is reasonable and pertinent.

ICC believes documentation of the arm's length price should be deemed to be adequate if the revenue authority of the related company confirms in writing the correctness of the price. Where such confirmation seems insufficient, confirmation by the revenue authority of the country where the parent company has its headquarters should be deemed sufficient. In this respect once again the importance of bilateral tax treaties must be stressed. They provide for the legal basis to exchange the information necessary to determine whether prices are at arm's length.

Finally, ICC would like to emphasise that in any international exchange of documentation, attention must be paid to the economic, financial, social and/or other differences between the countries which might give rise to different business decisions and/or create different results. Except in cases where tax evasion is involved taxpayers must be informed of any such exchange of information and be granted the opportunity to qualify the information to be exchanged.

Burden of proof

A key issue for all ICC members involves burden of proof. The tax systems differ considerably on this crucial issue. While in certain countries the taxpayer must demonstrate that the declared income is correct, others with civil law systems require that the tax authorities show why they believe the declared income to be incorrect. In the latter case, relevant information is requested of the taxpayer, but the burden of proof is not shifted.

A transfer pricing system which does not want to impede business will accept the general rule that the burden of proof for an adjustment of transfer prices is ultimately on the tax authorities. The complexity of transfer pricing only justifies that the taxpayer has the obligation to cooperate with the tax authorities in finding the facts. This is the tax practice in most OECD countries. The burden of proof for increasing the income by correcting a transfer price is on the side of the tax administration.

The problem with transfer prices in the US is mainly the fact that the US law puts the burden of proof on the taxpayer in a totally exaggerated way, by requesting the taxpayer to prove that the adjustment by the tax authorities is arbitrary and capricious. Such a rule is unfair to the taxpayer especially as it is combined with very burdensome documentation requirements. It should be an aim of the OECD to limit transfer pricing disputes. Transfer pricing adjustments should be limited to cases where a transfer price is clearly inconsistent with the arm's length principle.

Therefore, the Discussion Draft should clearly state that the tax authority has to present and prove the facts constituting the upper and lower limits of the arm's length price range. This will constitute prima facie what the range will be. If the tax authority reasonably presents and proves those facts, it is up to the taxpayer to present facts which show that in his special case the limits of the arm's length range have to be drawn wider. Thereby, the taxpayer may show that the tax authority's prima facie assumption is no longer valid. If the taxpayer succeeds in showing this, the burden of proof again lies with the tax authority.

These principles of prima facie evidence should be endorsed and emphasized by OECD. Considering that in the Anglo-American law tradition the rule of prima facie evidence might follow a different concept, OECD will have to state that there is a conflict of principles. OECD then will have to seek a solution which is tolerable both to the OECD member states and to the international business community. A solution could be to hold back tax authorities from exaggerated scrutiny and to ban penalties at least in those countries where the burden of proof is borne by the taxpayer.

Penalties

Penalties tend to fall into two categories. There are flat-rate monetary penalties for failing to file a full tax return or particular tax form. There are also penalties relating to (significant) under-filing of taxable income; these are usually calculated as a percentage of the additional tax liability.

ICC is of the opinion that, because of its very nature, an arm's length price is a matter of differing opinion even between independent experts, a taxpayer should normally not be liable to large penalties if transfer prices are corrected by the tax authorities. Especially not if the original price set could be argued to be at arm's length.

Most countries charge penalties where an incorrect tax return, statement or declaration is made by a company "fraudulently or negligently". By contrast the United States has specific penalty provisions directed at transfer pricing where the outcome of an inquiry is an increase in taxable profit. There are de minimis thresholds, but the largest multinational enterprises can trigger these de minimis amounts by quite small discrepancies in the transfer price. In practice de minimis provisions are unreliable. Enterprises may avoid the penalties provided they can show they had reasonable cause to submit the price they did on the valuation statement **and** acted in good faith with respect to the price. The problem of course is that no one knows what is necessary to show reasonable cause and, in particular, whether an inhouse valuation of transfer prices is sufficient.

ICC is of the opinion that a taxpayer should have certainty that a penalty will not be imposed if he has acted with reasonable care. If a transaction-based pricing method, which is commonly used by unrelated third parties for a given transaction, is capable of producing a reasonable approximation of an arm's length price, a taxpayer should not be required to provide, obtain, or create evidence that the chosen method was the most reliable method. Neither the reliability nor the utilisation of a customary transaction based method depends upon the sufficiency or degree of comparability of the data. In the normal course of day-to-day business of a multinational group, prior to the establishing of transfer prices, it is impossible to gather and perform a comparability analysis for each of possibly thousands of transactions involving a multitude of products to determine the most reliable method. A ranking of methods, in lieu of ascertaining whether the chosen pricing method was capable of producing an arm's length result, is an intolerable regulatory standard that unnecessarily defines the statutory requirement of "reasonable" in an unreasonably restrictive manner.

If a taxpayer consistently uses one of the traditionally internationally accepted transaction-based methods, comparable uncontrolled (CUP), resale price (RPM), or Cost Plus, there should be no penalty unless the taxpayer wilfully misapplies such method. All the more so, this should be the case if a taxpayer has and applies internal transfer pricing guidelines which require the use of such a method, and has an organisation in place which clearly indicates to those persons responsible for negotiating transfer prices that these guidelines are to be carefully observed.

Conclusion

The conclusion of ICC is that transfer pricing rules must not impede international business. The uncertainty about what the correct transfer price is, should in no case create a disadvantage for internationally operating companies.

Therefore it should be sufficient if the taxpayer

- demonstrates that the intercompany pricing within the group conforms to internationally recognized principles of transfer pricing, for example through internal transfer pricing guidelines,

- has an organization for the group on the basis of which it can be assumed as a general rule that the transfer prices are set with care in accordance with these guidelines on a consistent basis, and

- has selected a method which, having regard to the type of transaction, is customary among arm's length business partners and is internationally recognized.

Any further requirements - especially if enforced by penalties - would create the danger that the taxpayer tries to shift income to the country with the most burdensome rules in order to avoid problems.

Ladies and gentlemen, it is a pleasure being here and having had the opportunity to explain to you the position of ICC in the area of transfer pricing. I would like to finish my speech by telling you that of course the biggest Dutch experts in the area of transfer pricing are not here to day. Van Basten, Gullit and Cruijff are preparing for their next soccermatch.

Thank you.

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