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Comments on the OECD Public Discussion Draft entitled "Chapter I of the Transfer Pricing Guidelines (including Risk Recharacterisation, and Special Measures)" 1 December 2014 – 6 February 2015

Through its members, BUSINESSEUROPE represents 20 million European small, medium and large companies. BUSINESSEUROPE's members are 41 leading industrial and employers' federations from 35 European countries, working together since 1958 to achieve growth and competitiveness in Europe.

BUSINESSEUROPE is pleased to provide comments prepared by the members of its Tax Policy Group, chaired by Krister Andersson, on the OECD Discussion Draft entitled "Chapter I of the Transfer Pricing Guidelines (including Risk, Recharacterisation, and Special Measures)" 1 December 2014 – 6 February 2015 (hereinafter referred to as the Draft).

General Comments

BUSINESSEUROPE supports the OECD's ambition to improve the existing guidance on risk and to assure that transfer pricing outcomes are in line with value creation. In particular, we welcome the ambition to provide further guidance about (i) the accurate delineation of the actual transactions based on both the contractual arrangements (as a starting point) and the conduct of parties (just if in practice deviates substantially from contractual arrangements), (ii) the specification of associated risks and allocations of risk to risk management (as long as it is relevant and it does not determine a disproportionate increase of compliance burden for tax payers), and (iii) the non-recognition of transactions which lack the fundamental attributes of arrangements between unrelated parties (to the extent that adequate measures are included to ensure proper application to cases arising). Regarding this last point, BUSINESSEUROPE welcomes additional guidance on what is considered by fundamental attributes of operations for the proper application of the measure.
BUSINESSEUROPE agrees with the OECD that the mere contractual allocation of risk is not sufficient under the arm's length principle. BUSINESSEUROPE is however concerned that several of the new standards set out in Part 1 of the discussion draft is overly onerous and ambiguous and that they would be very hard to comply with in

practice. In particular, the principles set out in section D.2. seem to require risk identification and valuation at a level of detail which is hardly manageable in practice. By way of example, bench-marking data is typically not available at the level of detail required to conduct the exhaustive risk analysis required throughout the document. In this context, it should be recalled that a fundamental reason for MNEs to adopt TP-models with centralized risk taking (and IP) is due to the very fact that risk (and IP) is often very difficult to identify and value at a detailed level (at least before it materializes). We are therefore concerned that taxpayers with the best intentions to comply with the arm's length principles will fail or be seen to fail to comply with these new standards and hence face an increased risk of double taxation, disputes and/or re-characterisation.

BUSIENSSEUROPE thinks that it should be clarified that the purpose of the measures included in Part I is just providing additional guidance to taxpayers on how to perform the functional analysis considering the risk factor and its treatment, in order to correctly delineate transactions, rather than avoiding BEPS.

Special care is needed to ensure that the proposed measures are aimed at reviewing actual conducts and risk allocation but in general terms they should not result in an increase of re-characterization of the transactions already analyzed by MNEs.

As a general comment, further explanations and introductory comments regarding the reasons and purpose of each example included throughout the guidance are welcomed in order to ensure that tax payers understand in each scenario the importance of risks and its allocation.

Additionally, although carefully drafted examples may assist taxpayers and tax authorities in the implementation and follow up of transfer pricing models and policies, we think that many of the examples are overly simplified and that the conclusions drawn are overlooking several important aspects in commercial transactions.

By way of example, although the example set out in paragraphs 90 and 91 may seem reasonable at first glance, it completely neglects the fact that S1 is receiving 400MUSD as an upfront payment for the IP. Depending on the financial status of S1 it may very well make the deal at the terms set out in the example at arm's length if the alternative is financial crisis or even bankruptcy. This clearly illustrates the difficulty and risk with using simplified examples to illustrate the complex commercial reality that companies are operating under in today's global business environment.

If the examples are to be kept, BUSINESSEUROPE therefore believes that the paper should clearly underline that they are included for illustrative purposes only and that they frequently are not applicable to related transactions. Otherwise, the measures and examples proposed might create misunderstandings and disputes.

Regarding the potential special measures included in Part II, it should be remarked that the examples included are referred to very specific and limited related transactions in

which there is BEPS situation, which are not the general rule in the majority of the MNEs related party transactions.

In any case, the proposed measures are in a very embryonic stage and need further development so that they can be properly evaluated and thus contribute to the fight against BEPS situations.

The analysis of commercial and financial relations, together with (if necessary) the application of non-recognition rules, should be considered enough to guarantee a proper remuneration of the intragroup transactions within MNEs. Therefore, we consider that there would be no need for these special measures in order to avoid BEPS behaviours.

However, in case special measures are finally approved, we think it should be clearly expressed that they should apply only in exceptional cases. They should also be applied consistently by all tax Administrations in order to avoid an increase of tax disputes and potential double taxation.

Although, adjustment clauses are frequently used in acquisitions including IP, we see a risk that the suggestion in option 1 may open up for an arbitrary use of hindsight. We believe that a better approach is to include in the guidelines a recommendation to adopt adjustment clauses in cases where this can be expected in third party situations.

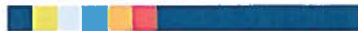
Although the drafting around options 2, 3 and 4 are still at a very embryonic stage, we fail to see how these options could be developed into rules which are sufficiently clear and adaptable to various market conditions and industries and which do not hamper genuine business activities.

Out of the suggested alternatives, we think that option 5 is the most reasonable one. Appropriately designed CFC-rules have the potential to mitigate important BEPS behaviour. Importantly, however, there needs to be a universal agreement on what is considered as an unacceptable tax level (and hence when CFC-taxation should be triggered).

A. REVISION TO SECTION D OF CHAPTER I OF TRANSFER PRICING GUIDELINES

1. Under the arm's length principle, what role, if any, should imputed moral hazard and contractual incentives play with respect to determining the allocation of risks and other conditions between associated enterprises?

Since most moral hazard situations are caused due to the lack of information and/or market inefficiencies, as a general rule, they should not have a relevant role in transactions between related parties.



However, situations of moral hazard may occur in those sectors where risk taking is a key part of the business (i.e. insurance industry).

It should be noted that this kind of situations might occur because they are imposed by regulated markets, public bodies or even by the tax Administrations, which limit by law the maximum risks of the companies operating in its country in order to ensure tax collection.

In accordance to the arm's length principle, except for some specific risk-taking based industries, these situations shall be amended from a tax perspective by remunerating each related party in accordance with the risk and functions actually assumed in the transaction. This also implies that additional measures should be considered to avoid potential double taxation.

2. How should the observation in paragraph 67 that unrelated parties may be unwilling to share insights about the core competencies for fear of losing intellectual property or market opportunities affect the analysis of transactions between associated enterprises?

In the current economic environment many MNEs may not be unwilling to share insights about the core competencies due to the fact that they are conceived as integrated businesses; relevant implications arise from this scheme as related party transactions conducted by group companies will not always be perfectly comparable to those conducted by independent parties.

Although no clear answer can be provided by either tax Administrations or international organizations for every situation and the priority of the arm's length principle is one of the fundamentals of transfer pricing, flexible approaches should be further analyzed in this regard.

Under this scenario, the limited functionality of one-sided transfer pricing methods has already been acknowledged by tax Administrations, international organizations and taxpayers, being therefore needed alternative approaches

3. In the example at paragraphs 90 and 91 how should moral hazard implications be taken into account under the arm's length principle?

Considering that the proposed scenario is based on tax nature reasons (low tax location involved) and not in business reasons, it is extremely difficult to justify a valuation of the intellectual property risks transferred to S2 under arm's length principle.

However, in a scenario in which business reasons sustain the ownership transfer of an asset (for example, because there is a high specialization component), the mentioned transaction should be assessed under the arm's length principle as a whole and attribute to S2 a portion of the results in accordance to the risk and functions assumed (similar to S1).

4. Under the arm's length principle, should transactions between associated enterprises be recognised where the sole effect is to shift risk? What are the examples of such transactions? If they should be recognised, how should they be treated?

MNEs transactions shall be based on economic and business reasons rather than on the sole effect of shifting risks between associated enterprises, particularly if low tax locations are involved. Thus, risks transfers can only be justified if there are economic or business reasons behind the transaction and such transfer is properly remunerated. As mentioned before, this may occur in those sectors where the risk taken is a key part of the business (i.e. insurance industry).

As a general rule, unless justified industry reasons are applicable, risk-return trade-off implications may be considered appropriate to value the risk and functions assumed by each related party under arm's length standard.

5. In the example at paragraphs 90 and 91, how does the asset transfer alter the risks assumed by two associated enterprises under the arm's length principle?

Compared to Company S1, Company S2 has less capability to manage and control the marketing which will affect the generation of expected income flows, and Company S2 has not a commercial position to enhance or to protect but it may damage it by not managing properly the asset-related risks.

In case of business reasons behind the example proposed, the mentioned transaction should be valued under arm's length principle as a whole and attribute S2 a portion of the results in accordance to the risk and functions assumed by each party.

6. In the example at paragraphs 90 and 91, how should risk-return trade-off implications be taken into account under the arm's length principle?

As mentioned before, since the proposed example at paragraphs 90 and 91 is built over the existence of pure tax reasons, under the arm's length principle it is difficult to determine the risk-return trade-off associated to the intellectual property transferred to S2.

In case business reasons were behind the example proposed, the mentioned transaction should be valued under arm's length principle as a whole and attribute to S2 a portion of the results in accordance to the risk and functions assumed by each party.

Again, an appropriate functional analysis needs to be conducted in order to justify that the compensation attributed to each entity is aligned with its functional profile.

7. Under the arm's length principle, does the risk-return trade-off apply in general to transactions involving as part of their aspect the shifting of risk? If so:

Yes

a) Are there limits to the extent that the risk-return trade-off should be applied? For example, can the risk-return trade-off be applied opportunistically in practice to support transactions that result in BEPS (for example by manipulating the discount rates to "prove" that the transaction is economically rational)?

Yes, limits should be applied. Business reasons behind transactions are needed for implementing risk-return trade-off approach. No opportunistic applications that resulted in BEPS should be admitted.

For this purpose, it is relevant to avoid falling into *probatio diabolica* scenarios in which tax Administrations require taxpayers to make prove of situations in which there is a rational lack of evidence or a burdensome level of compliance.

b) Are there measures that can be taken in relation to the risk-return trade-off issue to ensure appropriate policy outcomes (including the avoidance of BEPS) within the arm's length principle, or falling outside the arm's length principle?

Under arm's length principle appropriate outcomes are ensured by remunerating each entity in accordance with its functional and risk profile.

Measures outside the arm's length principle should be avoided in order to guarantee a coherent and consistent transfer pricing system.

8. Is the discussion of risk of a general nature such that the concepts apply to financial services activities notwithstanding the fact that for financial services activities risk is stock in trade and risk transfer is a core component of its business? If not, what distinctions should be made in the proposed guidance?

We understand that distinctions should be considered to financial services activities to the extent that risk is a core component of such industry. These distinctions should be settled under arm's length principle in order to avoid uncertain environment in terms of taxation.

B. OPTIONS FOR SOME SPECIAL MEASURES

As initially exposed, the proposed measures are at a very early stage and further development would be needed so that they can really be evaluated.

Additionally, these extraordinary measures require special mechanisms to limit its application to those cases in which BEPS really occur and avoid double taxation of profits.

Option 1: Hard to value intangibles (HTVI)

1. How well does the measure achieve the policy goal of ensuring a closer alignment between transfer pricing outcomes and value creation? What other alternatives might be available to achieve the goal? What design options for the particular measure would improve the achievement of this goal?

Although the measure entails aligning transfer pricing outcomes and value creation, the remuneration agreed under this approach would not be arm's length, since unrelated parties wouldn't have designed the remuneration in that way at the time the transaction occurred. Therefore, this special measure should not be reconsidered by the OECD since it creates further uncertainty for taxpayers.

In case this new measure is finally adopted, it should be applied in very exceptional cases, to the extent that the valuation method adopted is not aligned with arm's length principle.

In addition to other concepts, it is necessary to define what is meant by "robust projections" in order to implement the presumptions and establish some sort of guarantee to prove that the taxpayer has made reasonable efforts to made correct estimations based on the information available at the time the decision was taken (for example, technical reports issued by third parties validating that the estimations made by the company are reasonable at the moment they were proposed).

Finally, mechanisms for avoiding double taxation should be kept in all situations; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

2. What are the advantages and disadvantages of the measure, and relative to other measures?

The measure entails aligning transfer pricing outcomes and value creation.

However, as mentioned, the valuation approach proposed seems to be against the arm's length principle and introduces a high degree of uncertainty and subjectivity. Measures outside the arm's length principle should be avoided in order to guarantee a coherent and consistent transfer pricing system.

In addition and as indicated earlier, although adjustment clauses are frequently used in acquisitions including IP, we see a risk that the suggestion in option 1 may open up for an arbitrary use of hindsight. We believe that a better approach is to include in the guidelines a recommendation to adopt adjustment clauses in cases where this can be expected in third party situations.

3. What is the likely effect of the measure? Will it operate mainly as a deterrent and encourage behavioural changes, or will it require compliance and reporting? What issues are likely to arise in complying with and in administering the measure?

It is likely that the measures proposed could operate as a deterrent for BEPS situation. However, the measures seem far from proportionate since the administrative burden and cost for taxpayers would be very high. It obliges taxpayers to prove *a posteriori* that valuation made *a priori* was right, being otherwise and adjustment made.

4. Given the targeted circumstances in which the measure would apply, in what ways can transfer pricing rules and guidance or other rules be further adapted to target such circumstances in parallel to or as an alternative to this measure?

The measures proposed for these specific circumstances are not aligned with TP rules and guidance. Thus, the measure proposed is an alternative to TP rules.

Regarding hard to value intangibles, the proposed measure should be framed within the existing transfer pricing rules; even when no reliable comparable exist and a valuation is conducted, assumptions and hypothesis considered should be determined in accordance with the market practices.

Abandoning the use of the arm's length principles would lead us to an uncertain environment in terms of taxation that could generate undesirable consequences and even aggressive tax planning (in the absence of a common framework, MNE would tend to implement other structures without considering value creation).

5. How well does the measure target the focus of its application? What criteria for application of the measure, and other thresholds, should be considered to improve clarity of application? In particular what design features of the options will secure the likelihood that tax administrations, when considering the facts of a given case in the context of audit or competent authority proceedings, will agree the case meets the criteria for application of the measure and on the resulting adjustment?

In case they are implemented, these new rules should be applied to very extraordinary and restricted number of cases, to the extent that the valuation method is against arm's length principle.

Mechanisms for avoiding double taxation should be kept in all situations; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

6. Where the measure makes no reference to tax attributes, should criteria be included limiting the measure to circumstances where the arrangement results in a tax advantage to the group?

As repeatedly stated by the OECD, the aim of these measures is to avoid BEPS and thus their applicability should be limited to those situations in which the arrangements within MNEs result in distorted taxation. In general terms MNEs organize their business in those territories where their economic activity is conducted, being taxed accordingly. Only extraordinary situation should be targeted by these measures.

7. In what order should the measures apply? Does the measure come into consideration following the application of normal transfer pricing rules, or should it be applied instead of transfer pricing rules?

The application of the generally accepted transfer pricing rules should be a boundary condition for the application of any further special measures, which should be considered as a last-resort; indeed, any development by the OECD should be defined within the scope of the arm's length principle as it is the common ground accepted by all countries and the underlying principle in connection with the valuation of related party transactions.

Regarding hard to value intangibles, the proposed measure should be framed within the existing transfer pricing rules; even when no reliable comparable exist and a valuation is conducted, assumptions and hypothesis considered should be determined in accordance with market practices.

Abandoning the use of the arm's length principle would lead us to an uncertain environment in terms of taxation that would generate undesirable consequences and even much more aggressive tax planning (in the absence of a common framework, MNE would tend to implement other structures without considering value creation).

8. Should mechanisms be available for eliminating double taxation, even if the rules are considered to be anti-abuse measures, and how should any such mechanisms be framed?

Mechanisms for avoiding double taxation should be kept in all situations; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

9. Should certain sectors be excluded from the application of the measures? In particular, how should measures focussing on capital distinguish financial services activities where capital adequacy rules apply and where the amount of capital affects the amount of business that can be carried on?

Intangible valuations depend on the nature of the intangible itself as well as the related party affecting such intangible more than the sector in which the transaction is conducted.

10. What other measures would respondents wish to have considered, taking into account the policy goal of the BEPS Project, and what would the outline of such measures involve?

Considering the context of HTVI, both Tax Authorities and international organizations should be open-minded enough to accept alternative approaches for the purposes of valuing related party transactions affecting HTVI.

As regards the use of ex-ante information for intangibles valuation, this should be the general rule accepted and shared by all the industry players. Obliging the taxpayers to update their economic analysis with information that it is not available at the time the transactions in performed would result in an excessive administrative burden as well as a relevant (and unacceptable) increase of uncertainty in the valuation of their related party transactions.

Of course, the taxpayer should be ready to prove in front of the Tax Authorities that the information used for the valuation was accurate and objective at the moment the transaction was closed. Once this is ensured, no further reviews of the calculations by the taxpayers should be admissible.

Option 2: Independent investor

1. How well does the measure achieve the policy goal of ensuring a closer alignment between transfer pricing outcomes and value creation? What other alternatives might be available to achieve the goal? What design options for the particular measure would improve the achievement of this goal?

The measure proposed might entail aligning transfer pricing outcomes and value creation to the extent that the entity receiving the assets is not a low tax jurisdiction and there are business reasons behind the related transaction.

In practice, if approved, it should be stated that this special measure would be applicable to a very limited and justified number of cases since Tax Administrations will surely be tempted to apply this measure as a general rule.

The adoption of this new measure should be accompanied by the implementation of additional mechanisms to guarantee that double taxation doesn't occur in these specific transactions (i.e. taxation in S1country and S2 or P country).

2. What are the advantages and disadvantages of the measure, and relative to other measures?

The main advantage of the measure proposed is that it may imply an alignment between transfer pricing outcomes and value creation. However, again, it is needed to limit the application of this measure to those situations in which there are not business reasons behind transactions and BEPS occur.

Additionally, the proposed measure it is very theoretical and requires additional development and concretion. It is difficult to see how this option could be developed into a rule that is sufficiently clear and adaptable to various market conditions and industries so that it will not hamper genuine business activities. A generic application of the measure proposed and a lack of coordination between Tax Administrations can lead to double taxation situations.

3. What is the likely effect of the measure? Will it operate mainly as a deterrent and encourage behavioral changes, or will it require compliance and reporting? What issues are likely to arise in complying with and in administering the measure?

MNEs would probably need to invest additional costs in compliance and reporting activities because they would need to provide additional information that there are business reasons behind the transactions conducted by related parties.

4. Given the targeted circumstances in which the measure would apply, in what ways can transfer pricing rules and guidance or other rules be further adapted to target such circumstances in parallel to or as an alternative to this measure?

The measure proposed for "Independent investor" scenarios may have some room under the proposed revision to both Sections D.3 "Interpretation" and D.4 "Non recognition" of Chapter I of the Transfer Pricing Guidelines.

In addition, the application of this measure should rely on a thorough comparability analysis in order to identify function, risks and assets assumed/borne by each party and thus, the remuneration that should be granted to each of them according to their contribution.

5. How well does the measure target the focus of its application? What criteria for application of the measure, and other thresholds, should be considered to improve clarity of application? In particular what design features of the options will secure the likelihood that tax administrations, when considering the facts of a given case in the context of audit or competent authority proceedings, will agree the case meets the criteria for application of the measure and on the resulting adjustment?

The application of this measure should be limited to those cases in which there are not business reasons behind transactions conducted between related parties and there is a BEPS situation.

In any case, mechanisms for avoiding double taxation should be kept in all situations; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

Again, the current status of this measure is very broad and generic and it is difficult to assess concrete consequences.

6. Where the measure makes no reference to tax attributes, should criteria be included limiting the measure to circumstances where the arrangement results in a tax advantage to the group?

As repeatedly stated by the OECD, the aim of these measures is to avoid BEPS and thus their applicability should be limited to those situations in which the arrangements within MNEs result in distorted taxation. In general terms MNEs organize their business in those territories where their economic activity is conducted, being taxed accordingly.

These measures should only apply in exceptional cases.

7. In what order should the measures apply? Does the measure come into consideration following the application of normal transfer pricing rules, or should it be applied instead of transfer pricing rules?

The application of the generally accepted transfer pricing rules should be a boundary condition for the application of any further measures; indeed, any development by the OECD should be defined within the scope of the arm's length principle as it is the common ground accepted by countries and the underlying principle in connection with the valuation of related party transactions. In this case, the application of the measure should be based in a comparability analysis following the five OECD comparability factors.

Abandoning the use of the arm's length principle would lead us to an uncertain environment in terms of taxation that could generate undesirable consequences and even much more aggressive tax planning (in the absence of a common framework, MNE would tend to implement other structures without considering value creation).

8. Should mechanisms be available for eliminating double taxation, even if the rules are considered to be anti-abuse measures, and how should any such mechanisms be framed?

Of course, mechanisms for avoiding double taxation should be kept in all situations; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

9. Should certain sectors be excluded from the application of the measures? In particular, how should measures focussing on capital distinguish financial services activities where capital adequacy rules apply and where the amount of capital affects the amount of business that can be carried on?

We don't have comments on this.

10. What other measures would respondents wish to have considered, taking into account the policy goal of the BEPS Project, and what would the outline of such measures involve?

Both Tax Authorities and international organizations should be open-minded enough to accept alternative approaches for the purposes of valuing related party transactions.

Nevertheless, it is highly desirable that additional mechanism are in place for avoiding double taxation; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

Option 3: Thick capitalisation

1. How well does the measure achieve the policy goal of ensuring a closer alignment between transfer pricing outcomes and value creation? What other alternatives might be available to achieve the goal? What design options for the particular measure would improve the achievement of this goal?

The measure proposed is far from aligning transfer pricing outcomes and value creation. We do not perceive the existence of BEPS situations in such cases to the extent that the capital contributed are related to the development of actual business activities.

Adopting measures to limit the maximum amount of capital contributions may hinder the implementation of MNE investment strategies. Taxation should not influence business decisions and must be configured as a neutral element.

In any case, further developments are required in the measures proposed (for example, adaption of a "predeterminated capital ratio to each industry and country, based on a benchmarking of the market) so it can be properly analyzed and evaluated.

Additional mechanisms should be implemented to avoid double taxation due to the application of the measure proposed to this kind of transactions.

2. What are the advantages and disadvantages of the measure, and relative to other measures?

We do not foresee any advantage to the measure proposed to the extent that there are economic and business reasons behind capital contributions conducted by enterprises.

3. What is the likely effect of the measure? Will it operate mainly as a deterrent and encourage behavioural changes, or will it require compliance and reporting? What issues are likely to arise in complying with and in administering the measure?

MNE would probably need to invest additional costs in compliance and reporting activities because they would need to support with additional information that there are business reasons behind the transactions conducted by related parties.

4. Given the targeted circumstances in which the measure would apply, in what ways can transfer pricing rules and guidance or other rules be further adapted to target such circumstances in parallel to or as an alternative to this measure?

The measure proposed for "Thick capitalisation" scenarios may be included under the proposed revision of Sections D.3 "Interpretation" contained in Chapter I of the Transfer Pricing Guidelines.

5. How well does the measure target the focus of its application? What criteria for application of the measure, and other thresholds, should be considered to improve clarity of application? In particular what design features of the options will secure the likelihood that tax administrations, when considering the facts of a given case in the context of audit or competent authority proceedings, will agree the case meets the criteria for application of the measure and on the resulting adjustment?

The existence of BEPS situation and the absence of business economic reasons should be considered as a threshold to improve clarity of application.

Finally, additional mechanisms for avoiding the double taxation of this kind of transactions should be adopted to guarantee arm's length standards.

6. Where the measure makes no reference to tax attributes, should criteria be included limiting the measure to circumstances where the arrangement results in a tax advantage to the group?

As repeatedly stated by the OECD, the aim of these measures is to avoid BEPS and thus their applicability should be limited to those situations in which the arrangements within MNEs result in distorted taxation. In general terms MNEs organize their business in those territories where their economic activity is conducted, being taxed accordingly.

These measures should only apply in exceptional cases.

7. In what order should the measures apply? Does the measure come into consideration following the application of normal transfer pricing rules, or should it be applied instead of transfer pricing rules?

The application of the generally accepted transfer pricing rules should be a boundary condition for the application of any further measures; indeed, any development by the OECD should be defined within the scope of the arm's length principle as it is the common ground accepted by all countries and the underlying principle in connection with the valuation of related party transactions.

Abandoning the use of the arm's length principles would lead us to an uncertain environment in terms of taxation that could generate undesirable consequences and even much more aggressive tax planning (in the absence of a common framework, MNE would tend to implement other structures without considering value creation).

8. Should mechanisms be available for eliminating double taxation, even if the rules are considered to be anti-abuse measures, and how should any such mechanisms be framed?

Mechanisms for avoiding double taxation should be kept in all situations; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as a relevant tool.

9. Should certain sectors be excluded from the application of the measures? In particular, how should measures focussing on capital distinguish financial services activities where capital adequacy rules apply and where the amount of capital affects the amount of business that can be carried on?

A further development is required to adapt the measure and definitions proposed to each industry and country particularities.

10. What other measures would respondents wish to have considered, taking into account the policy goal of the BEPS Project, and what would the outline of such measures involve?

Both Tax Authorities and international organizations should be open-minded enough to accept alternative approaches for the purposes of valuing related party transactions.

Nevertheless, it is highly desirable that additional mechanism are in place for avoiding double taxation; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

Option 4: Minimal functional entity

1. How well does the measure achieve the policy goal of ensuring a closer alignment between transfer pricing outcomes and value creation? What other alternatives might be available to achieve the goal? What design options for the particular measure would improve the achievement of this goal?

The measure proposed could entail aligning transfer pricing outcomes and value creation. It is necessary to avoid generic thresholds that, in most cases, would not imply a BEPS situation neither the transfer of benefits to another tax jurisdiction.

Additionally, the actual economic and business reasons behind each transaction with related parties should be considered before the measure is applied.

However, as mentioned before, we do not consider necessary the implementation of special measures to fight against BEPS behaviour; the application of the current transfer pricing regulation would permit a thorough comparability analysis in order to identify function, risks and assets assumed/borne by each party and thus, the remuneration that should be granted to each of them according to their contribution.

2. What are the advantages and disadvantages of the measure, and relative to other measures?

The main advantage of the measure proposed is that its proper and accurate implementation can imply an alignment between transfer pricing outcomes and value creation. . However criteria for development and implementation need to be more fully considered before this option could be supported.

Nevertheless, the proposed measure requires much development and concretion. We fail to see how this option could be developed into rules which are sufficiently clear and adaptable to various market conditions and industries and which do not hamper genuine business activities. A generic application of the measure proposed and a lack of coordination between tax Administrations can lead to double taxation scenarios. In addition it introduces a high degree of uncertainty for taxpayers; the return of a given entity should be based in its functional profile and not generic rules that do not take into consideration all the comparability factors stated by the OECD.

3. What is the likely effect of the measure? Will it operate mainly as a deterrent and encourage behavioural changes, or will it require compliance and reporting? What issues are likely to arise in complying with and in administering the measure?

MNEs would probably need to invest additional costs in compliance and reporting activities because they would need to provide additional information that these "minimal functions entities" are conduction business and paid in accordance with the actual functions and risk assumed.

In addition, we do not believe that this measure is necessary as the existing transfer pricing regulatory framework already permits avoiding BEPS situations.

4. Given the targeted circumstances in which the measure would apply, in what ways can transfer pricing rules and guidance or other rules be further adapted to target such circumstances in parallel to or as an alternative to this measure?

The measure proposed for "Minimal function entity" scenarios could be included under the proposed revision of Sections D.3 "Interpretation" contained in Chapter I of the Transfer Pricing Guidelines. However, the scenarios could better serve as examples demonstrating BEPS behaviour which may be better served as part of anti-avoidance rules.

5. How well does the measure target the focus of its application? What criteria for application of the measure, and other thresholds, should be considered to improve clarity of application? In particular what design features of the options will secure the likelihood that tax administrations, when considering the facts of a given case in the context of audit or competent authority proceedings, will agree the case meets the criteria for application of the measure and on the resulting adjustment?

The existence of BEPS situation and the absence of business economic reasons should be considered as a threshold to improve clarity of application.

Additional mechanisms for avoiding the double taxation of this kind of transactions should be adopted to guarantee arm's length standards.

6. Where the measure makes no reference to tax attributes, should criteria be included limiting the measure to circumstances where the arrangement results in a tax advantage to the group?

As repeatedly stated by the OECD, the aim of these measures is to avoid BEPS and thus their applicability should be limited to those situations in which the arrangements within MNEs result in distorted taxation. In general terms MNEs organize their business in those territories where their economic activity is conducted, being taxed accordingly. These measures should only apply in exceptional cases.

7. In what order should the measures apply? Does the measure come into consideration following the application of normal transfer pricing rules, or should it be applied instead of transfer pricing rules?

The application of the generally accepted transfer pricing rules should be a boundary condition for the application of any further measures; indeed, any development by the OECD should be defined within the scope of the arm's length principle as it is the common ground accepted by all countries and the underlying principle in connection with the valuation of related party transactions.

Abandoning the use of the arm's length principle would lead to an uncertain environment in terms of taxation that could generate undesirable consequences and even much more aggressive tax planning (in the absence of a common framework, MNE would tend to implement other structures without considering value creation).

8. Should mechanisms be available for eliminating double taxation, even if the rules are considered to be anti-abuse measures, and how should any such mechanisms be framed?

Definitively, yes. Mechanisms for avoiding double taxation should be developed in all situations; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

9. Should certain sectors be excluded from the application of the measures? In particular, how should measures focussing on capital distinguish financial services activities where capital adequacy rules apply and where the amount of capital affects the amount of business that can be carried on?

We don't have comments on this.

10. What other measures would respondents wish to have considered, taking into account the policy goal of the BEPS Project, and what would the outline of such measures involve?

Both Tax Authorities and international organizations should be open-minded enough to accept alternative approaches for the purposes of valuing related party transactions.

Nevertheless, it is highly desirable that additional mechanism are in place for avoiding double taxation; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

Option 5: Ensuring appropriate taxation of excess returns

1. How well does the measure achieve the policy goal of ensuring a closer alignment between transfer pricing outcomes and value creation? What other alternatives might be available to achieve the goal? What design options for the particular measure would improve the achievement of this goal?

The measure proposed could entail aligning transfer pricing outcomes and value creation. It is necessary to avoid generic thresholds that, in most cases, would not imply a BEPS situation neither the transfer of benefits to another tax jurisdiction.

Additionally, to make this measure applicable it would be necessary to define what is considered by "excess of benefit" and the circumstances that determine the application of "primary" and "secondary" rules in order to avoid uncertainties regarding the jurisdiction to which profits must be allocated.

Again, additional mechanisms for avoiding the double taxation of this kind of transactions should be adopted to guarantee arm's length standards.

2. What are the advantages and disadvantages of the measure, and relative to other measures?

The main advantage of the measure proposed is that in some specific cases it can imply an alignment between transfer pricing outcomes and value creation.

In the same way as in previous measures, the main disadvantage is that the proposed measure has to be detailed and developed in order to be applicable and solve real BEPS situations.

As mentioned in our general remarks, we believe that compared to the other options, option 5 is the most reasonable one. Appropriately designed CFC-rules has the potential to mitigate important BEPS behaviour. Importantly, however, there needs to be a universal agreement on what is considered as an unacceptable tax level (and hence when CFC-taxation should be triggered).

3. What is the likely effect of the measure? Will it operate mainly as a deterrent and encourage behavioral changes, or will it require compliance and reporting? What issues are likely to arise in complying with and in administering the measure?

MNE would probably need to invest additional costs in compliance and reporting activities because it would be needed to support with additional information that this specific transactions are based on business reasons.

4. Given the targeted circumstances in which the measure would apply, in what ways can transfer pricing rules and guidance or other rules be further adapted to target such circumstances in parallel to or as an alternative to this measure?

The measure proposed for "Minimal function entity" scenarios may be included under the proposed revision of Sections D.3 "Interpretation" contained in Chapter I of the Transfer Pricing Guidelines.

Additionally, Profit split method will be applicable in order to re-allocate profits to each entity in accordance with their actual functions.

5. How well does the measure target the focus of its application? What criteria for application of the measure, and other thresholds, should be considered to improve clarity of application? In particular what design features of the options will secure the likelihood that tax administrations, when considering the facts of a given case in the context of audit or competent authority proceedings, will agree the case meets the criteria for application of the measure and on the resulting adjustment?

The application of this measure should be limited just to those cases in which there are not business reasons behind transactions conducted between related parties and there is a BEPS situation.

Again, mechanisms for avoiding double taxation should be kept in all situations; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

6. Where the measure makes no reference to tax attributes, should criteria be included limiting the measure to circumstances where the arrangement results in a tax advantage to the group?

As repeatedly stated by the OECD, the aim of these measures is to avoid BEPS and thus their applicability should be limited to those situations in which the arrangements within MNEs result in distorted taxation. In general terms MNEs organize their business in those territories where their economic activity is conducted, being taxed accordingly. Only extraordinary situation should be refrained by using these measures.

7. In what order should the measures apply? Does the measure come into consideration following the application of normal transfer pricing rules, or should it be applied instead of transfer pricing rules?

The application of the generally accepted transfer pricing rules should be a boundary condition for the application of any further measures; indeed, any development by the OECD should be defined within the scope of the arm's length principle as it is the common ground accepted by all countries and the underlying principle in connection with the valuation of related party transactions.

Abandoning the use of the arm's length principle would lead to an uncertain environment in terms of taxation that could generate undesirable consequences and even much more aggressive tax planning (in the absence of a common framework, MNE would tend to implement other structures without considering value creation).

8. Should mechanisms be available for eliminating double taxation, even if the rules are considered to be anti-abuse measures, and how should any such mechanisms be framed?

Yes. Mechanisms for avoiding double taxation should be kept in all situations; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

9. Should certain sectors be excluded from the application of the measures? In particular, how should measures focussing on capital distinguish financial services activities where capital adequacy rules apply and where the amount of capital affects the amount of business that can be carried on?

We don't have comments on this.

10. What other measures would respondents wish to have considered, taking into account the policy goal of the BEPS Project, and what would the outline of such measures involve?

Both Tax Authorities and international organizations should be open-minded enough in order to accept alternative approaches for the purposes of valuing related party transactions.

Nevertheless, it is highly desirable that additional mechanism are in place for avoiding double taxation; as long as anti-abuse measures are not adopted and implemented by all countries in similar terms, double taxation could be generated and therefore any mechanism to avoid it should be considered as relevant tools.

Consequently, we urge the OECD to carefully consider these aspects in the process ahead.

BUSINESSEUROPE would be willing to engage in a constructive dialogue with the OECD on risk recharacterisation and special measures.

On behalf of the BUSINESSEUROPE Tax Policy Group

Yours sincerely,

James Watson
Director
Economics Department