

European Business Initiative on Taxation - EBIT

Comments on OECD Discussion Draft for Public Comment on
Transfer Pricing Aspects of Business Restructurings

Mr. Jeffrey Owens
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Dear Mr Owens

Re: Transfer Pricing Aspects of Business Restructurings
Discussion Draft for Public Comment

This letter sets out the comments of the European Business Initiative on Taxation (EBIT) on the OECD Discussion Draft for Public Comment (the "Discussion Draft") on Transfer Pricing Aspects of Business Restructurings.

EBIT¹ considers that this is an extremely important topic for business and day-to-day tax practitioners and therefore it welcomes this opportunity to provide its comments on the Discussion Draft. EBIT commends the OECD for its overall even-handed and pragmatic analysis on this topic, which we consider to be an important first step for building a common understanding and international consensus among business, the OECD and its member states of transfer pricing aspects of business restructurings. However, there are a number of important points in the Discussion Draft with which EBIT disagrees, as are explained in more detail below, and which it would like to see modified in the final report.

In developing this submission, EBIT has relied more on the practical and daily experience of its members, who are experienced tax executives of multinational enterprises, than on a theoretical analysis. EBIT also notes and concurs with the response to the OECD on this topic submitted by PricewaterhouseCoopers.

1. Commercial rationality / disregarding of transactions

EBIT fully supports the principle in the Discussion Draft stating that Multinational Enterprises (MNEs) are free to organise their business operations as they see fit and are free to act in their own best economic interest.

Our concerns in this respect relate in particular to the ability for tax authorities to disregard the actual transaction if a restructuring is deemed not to be "commercially rational".

- In EBIT's view, the vast majority of business restructurings are carried out for bona-fide commercial reasons, e.g. cost efficiency purposes or to align an acquisition with the existing business model. These reorganisations are inextricably linked to the

¹ At the time of writing this submission, members of EBIT included: AIRBUS, BOMBARDIER TRANSPORTATION, CATERPILLAR, CORPORATE EXPRESS, EADS, GE, GUCCI GROUP, LUFTHANSA, METRO GROUP, MTU AERO ENGINES, NUTRECO, ORACLE, PROCTER & GAMBLE, ROLLS-ROYCE, ROMPETROL GROUP, SANOFI-AVENTIS, SES GLOBAL and TUPPERWARE.

ongoing efforts of businesses to remain efficient and competitive. In this respect, EBIT notes that tax savings can result from business restructurings which are not necessarily artificial. Hence, the overall commercial rationale for a business restructuring is not in EBIT's opinion prejudiced by the presence of tax savings especially in combination with organisational restructurings.

- Only under exceptional circumstances where the restructuring clearly constitutes a sham or is solely aimed at securing unwarranted tax benefits, do we agree that transactions should indeed be scrutinised.
- Furthermore, EBIT agrees that the assessment should be made at group level. The fact that an individual group member would not have entered into the transaction should not provide a basis for disregarding the group's commercial reasons for restructuring.
- Our main concern however is that the definition of "commercially rational" at this stage is much too ambiguously defined in the Discussion Draft and could lead to undue discussions on the rationality of restructurings and the disregarding of transactions which have in principle sound business reasons.

2. Risks

- Issue Note Nr. 1 of the Discussion Draft on Special Considerations for Risks focuses on risk allocation and "control". Paragraph 28 of the Discussion Draft states that one factor that can assist in determining whether the allocation of risk can be considered to be at arm's length is the control over the risk. According to the OECD, another factor that may influence an independent party's willingness to take on a risk is its anticipated financial capacity to bear that risk.
- In EBIT's view the Discussion Draft's line of reasoning should be the other way around. The starting point for the willingness to take on a risk will always be the financial capacity to bear that risk. The emphasis on "control" underestimates the importance of financial risk bearing in this respect.
- Furthermore, the definition of "control" in the Discussion Draft should be specified further to determine what type of control is meant. As risk control can be organised centrally, with compliance organised at a local / regional level, for a company that assumes risk, it is not necessarily essential to have day-to-day administration although it is very important as regards the location of the decision-making in respect of the risk.

3. Contractual terms

- EBIT agrees with the Discussion Draft that, for the analysis of a business restructuring, written agreements and contracts are the evident starting point.
- EBIT's concern is that the current extensive documentation requirements in the Discussion Draft insufficiently recognise the fact that in practice, transactions and arrangements within a group will not always be laid down in writing extensively and sometimes will depend on oral agreements and the conduct of the parties.
- In intra-group situations, it is less important to have detailed contracts to cover all eventualities as the levels of trust and control are intrinsically different from a third party situation. Therefore, the fact that certain agreements / arrangements which are

part of a restructuring have not been laid down in writing should not imply that they are therefore not at arm's length.

4. Restructuring / transfer of assets

- It is EBIT's opinion that taxation can only be based on a transfer of tangible or intangible assets. EBIT particularly welcomes the OECD's firm position that profit potential in itself does not constitute an asset

5. Domestic anti-abuse rules

- We appreciate the intention of the Discussion Draft to leave domestic anti-abuse rules out of scope. However, EBIT's experience is that some tax authorities of OECD member countries are seeking support or justification for their domestic anti-abuse legislation through the Discussion Draft. This is for example the case with Germany regarding its recently introduced taxation of the transfer of functions ("Funktionsverlagerung"). We would refer to our comments below under exit barriers regarding the unenforceability under the EC Treaty which apply equally here.
- EBIT is concerned that by seeking the largest common denominator among the OECD's 30 member countries regarding the taxation of the transfer of functions might trigger unintended domestic political discussions and conflicts between tax authorities and tax payers, and double taxation, whereas the goal for the OECD is exactly to avoid such discussions and conflicts.

6. Exit barriers

- Exit taxation creates tax barriers and is not conducive to competitiveness and economic growth. Given the current lack of unambiguous interpretation in the Discussion Draft and the fear of adverse implications in terms of exit charges, EBIT is concerned that the Discussion Draft might impose barriers for outbound investments, for which economically rational objectives exist.
- Moreover, for many OECD members subject to the EC Treaty, such exit charges are unlikely to be enforceable, having regard to the case law of the European Court of Justice.

7. Documentation

- At several points in the Discussion Draft suggestions are made that taxpayers should provide extensive documentation related to their restructuring transactions. Before and after analyses, contracts, assumptions regarding financial outcomes, and descriptions of motivations all are demanded in one form or another.
- EBIT notes the almost automatic acceptance of increasing the administrative burden in terms of documentation demands made on companies. EBIT appeals to the OECD not to go down this route but to focus more on the practical implications of documentation requirements for businesses and ensure the actual usefulness of the information for the tax authorities.

8. Liquidity / realisation principle

- Exit charges on expected future profits might lead to significant liquidity issues. EBIT believes that these charges on future potential profits are a violation of the realisation

principle. EBIT strongly recommends avoiding any mismatch between jurisdictions on exit charges and step-up upon importation of tangible or intangible assets (such as goodwill) in case of cross-border transactions and would like any final report to be aligned with EC Treaty principles (e.g. freedom of establishment or free movement of capital).

EBIT would like to encourage the OECD in its wider consultation effort on this difficult topic and hopes that the above points are useful and will be taken into account. EBIT looks forward to any further discussions in this respect. EBIT can be contacted through its Secretariat.

Yours sincerely,

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