**Draft ICC Comments on OECD Discussion Draft Chapter IV of the Transfer Pricing Guidelines**

The International Chamber of Commerce (ICC) welcomes the opportunity to provide input on the Organisation for Economic Co-operation and Development's (OECD) call for comments concerning a possible updating of Chapter IV of the OECD Transfer Pricing Guidelines (the ***TP Guidelines***). ICC believes that the updating of Chapter IV is an important consideration in the post-BEPS world, where transfer pricing controversy is an increasingly relevant consideration, both for multinationals and tax administrations alike.

ICC duly notes the increase in competent authority caseloads around the world, and the increasing focus on transfer pricing audits by tax administrations globally. In many respects, concerns around transfer pricing practices appear to have been central to the OECD's Base Erosion and Profit Shifting project (the ***BEPS project***), and seem to have driven a number of the Actions proposed as part of that project, including:

- Country-by-country reporting;
- Transfer pricing documentation;
- The concept of special measures in transfer pricing;
- The special rules introduced for the transfer pricing of intangibles, including those on so-called 'hard-to-value' intangibles; and
- Cost contribution agreements.

There is an increasing need for the business community to have additional certainty around the timely resolution of transfer pricing disputes.

ICC recognises the efforts put forward by the OECD in the context of other aspects of the BEPS Project (such as Action 14 on making dispute resolution mechanisms more effective), but holds that more could be done to simplify resolution and believes that the updating of Chapter IV of the TP Guidelines could play an important role in this process.

In this context, ICC notes the benefits not only to taxpayers, but also to resource-constrained tax administrations, which are increasingly under pressure to focus their efforts on situations involving higher levels of transfer pricing risk. ICC believes that the following principles are relevant when considering potential revisions to Chapter IV of the TP Guidelines:

- The guidance on examination practices should be expanded to include guidance on pre-audit procedures;
- Standardisation of examination practices is desirable, and efforts should be made to achieve this wherever possible – suggestions on how this may be facilitated are included further below. ICC members believe that the revisions to Chapter IV of the TP Guidelines should incorporate suggested best practices in this regard;
- Access to mandatory binding arbitration should be available wherever possible, noting in particular the proliferation of transfer pricing audits in recent years;
- Chapter IV should be updated to reflect the introduction of the OECD's 'Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting' (the ***MLI***);
- More detailed guidance should be included on the use of secondary adjustments, along with a clearer statement from the OECD recommending against their use by tax administrations; and
- The revised guidance on Chapter IV of the TP Guidelines should specifically include additional options that are relevant to the administration of transfer pricing and/or to the prevention and resolution of transfer pricing disputes[1].

[1] Experience with the array of programmes created and run by the IRS in the US transfer pricing context may be instructive here, as are other ongoing multilateral initiatives.(see Annex 1 below)

ICC has provided input below on each of the specific areas highlighted in the OECD's call for comments, taking into account and reflecting the foregoing principles. ICC firmly believes that it is critical to consider whether other approaches can be considered beyond those typically employed. A coordinated approach to transfer pricing risk assessment is necessary across all interested tax administrations and jurisdictions.

*Additional aspects or mechanisms that could be included in Chapter IV in order to minimise the risk of transfer pricing disputes*

ICC strongly believes that Chapter IV of the TP Guidelines can be significantly improved by the introduction of additional guidance on examination practices. The current guidance deals with this area only in passing, and does not address pre-audit scenarios. ICC believes that this needs to be remedied in the revised version of Chapter IV.

ICC believes that the OECD should draft standardised guidance on the conduct of risk assessment in the pre-audit phase. That guidance should include in particular:

- Recognition that there needs to be a balance between the resources required for a risk assessment, and those reserved for audit cases. There should also be a clear recognition that not all cases selected for audit by the risk assessment procedure will actually result in an adjustment;
- Encouragement, promotion and enhancement of simultaneous cooperation mechanisms between tax administrations aimed at establishing more efficient investigations as well as optimizing resources and dedication from both taxpayers and tax authorities;
- Guidance on the length of time that a risk assessment should last (ICC recommends that it should last no longer than 6 months);
- Guidance on how to use formulaic risk assessment procedures (including in relation to the weighting of risk triggers);
- Recognition that complicated taxpayers may not be suited to formulaic risk assessment procedures, and that enhanced taxpayer-tax administration dialogue may actually be preferable for such situations;
- Recognition that the size of a transaction should not automatically indicate high risk *per se*;
- Confirmation that an audit does not necessary need to be wide-ranging: on the contrary, it may be relatively focused in nature and based only on a single issue identified in the risk assessment;
- A recommendation that risk assessment should not be an annual exercise;
- Confirmation that a taxpayer's transfer pricing documentation should be taken as the starting point for tax administrations from which to begin a risk assessment;
- Confirmation that a risk assessment process is a two-way street, and that tax administrations must proactively engage with the process and educate themselves on the taxpayer's business model, industry, operating structure, *etc*;
- Guidance on the categories of transactions where transfer pricing risk is more likely to exist; and
- A recommendation that the risk assessment outcome should be shared with the taxpayer in question.

Moreover, ICC believes that a standardised examination procedure should be drafted by the OECD and enshrined as a recommended form of best practice in the revised Chapter IV. Such a procedure could be drafted on the basis of pre-existing approaches as noted above and could also draw on certain aspects of the guidance in the United Nations Practical Manual on Transfer Pricing for Developing Countries.

A standardised examination procedure would likely include in particular the following matters:

- A confirmation of the principles underpinning transfer pricing risk assessment;
- The levels of certainty required in such assessments;
- The approach to follow in conducting a transfer pricing risk assessment (including the questions to be answered, such as the identification of controlled transactions, whether there are indicia of transfer pricing risk, and what specific issues need to be addressed during the audit);
- Guidance on risk factors for a transfer pricing risk assessment;
- Guidance on how to evaluate the overall transfer pricing risk position;
- Guidance on the appropriate sources of information for a transfer pricing risk assessment; and
- Guidance on the administrative aspects of running a risk assessment, including in relation to the preparation of a risk assessment roadmap, the procedures and steps involved in a risk assessment, the preparation of a risk assessment report and communication procedures.

*Additional guidance that would be useful in relation to corresponding and/or secondary adjustments to minimise the risk of double taxation*

*Secondary adjustments*

ICC does not support the use of secondary adjustments in the transfer pricing space. As noted by the existing guidance on Chapter IV, secondary adjustments inevitably lead to cash flow problems for taxpayers and significant difficulties in resolving transfer pricing disputes (as they will generally not be relieved under domestic compensating adjustment provisions, and are not explicitly addressed by the OECD Model Tax Convention on Income and on Capital (the ***Model Treaty***)).

ICC would therefore recommend that a clear statement be included in the revised Chapter IV to the effect that the OECD recommends against the use of secondary adjustments. The existing guidance on this topic is non-committal, which is difficult to justify in view of the clear position taken in other parts of Chapter IV on related topics (for example, the guidance on safe harbours).

Moreover, while the number of tax administrations globally that use secondary adjustments continues to be relatively few, it is possible that their use could increase in the coming years as more and more tax administrations build their transfer pricing capabilities and start to look at their tax base defence policies.

A clear statement from the OECD against the use of secondary adjustments would therefore be helpful. In ICC's view, the existing guidance oversimplifies the issues with this topic, as it simply encourages concerned tax administrations to seek to make the necessary adjustments in order to achieve neutrality in the light of a secondary adjustment. This overlooks the fact that a tax administration on the other end of a secondary adjustment may simply not respect the deemed transaction.

In addition to the above, ICC suggests that the OECD considers including some additional guidance around safeguards for the use of secondary adjustments. These could, for example, include some or all of the following areas:

- A recommendation that secondary adjustments are used only in situations involving a tax avoidance motive;
- A recommendation that secondary adjustments should be based either on constructive loans or on constructive dividends/equity contributions. Existing secondary adjustment regimes generally fall into the latter category, so the purpose of this recommendation would be to encourage new rules in other jurisdictions to be aligned so as to limit, as far as possible, the issues that a secondary adjustment will raise for a taxpayer;
- A recommendation that a secondary adjustment should not be a punitive measure, and should instead be an adjustment aimed at relieving the economic effect of a primary transfer pricing adjustment;
- Linked with the point above, the guidance could also potentially include a recommendation that secondary adjustments should be imposed only following central approval within a domestic tax administration (ideally, to make it clear that fieldworkers should not have authority to impose secondary adjustments, and that they should be very much the exception rather than the rule);
- A recommendation on the ability to net off transactions (for example, cross-balances in the context of intra-group cash pooling arrangements); and
- Recommendations on the introduction of thresholds for the application of secondary adjustments – for example, a guideline that secondary adjustments should only be applied in the context of a primary adjustment of US$10m or more.

Additionally, ICC respectfully encourages the OECD to consider taking up the issue of secondary adjustments in Article 9 of the Model Treaty. Specifically, this Article could be amended to provide for dispute resolution mechanisms in relation to situations involving secondary adjustments.

In terms of corresponding adjustments ICC would welcome the OECD considering two points. Firstly, from time to time, M&A activity means that individual taxpayers within a multinational enterprise can become unrelated. We would therefore welcome the OECD clarifying that transfer pricing adjustments (including corresponding adjustments) can be made on the face of the tax return, without corresponding cash movements.

Secondly, it would be welcomed by taxpayers if the guidelines made it clear that it would be best practice to allow taxpayers to reclaim both tax withheld, and irrecoverable indirect tax suffered, on amounts adjusted after a Mutual Agreement Procedure (MAP).

In terms of penalties, criminal proceedings and the burden of proof, the new master file and local file transfer pricing documentation now includes a significant amount of information and requires the taxpayer to explain the pricing selected and support that decision. This requires a not insignificant investment from the taxpayer. Currently Chapter IV of the OECD TP Guidelines (as amended in line with the final report on action 13) suggests that penalties could be waived and the burden of proof moved to the tax authority where documentation meets the requirements and is timely submitted. ICC's view is that the guidelines should make it clear that it is best practice that if the master file and local file (or domestic equivalent) is materially complete that the burden of proof should be on the tax administration to prove that the transfer pricing is non-arm's length before any adjustment. Furthermore, there should be no penalties imposed on tax payers if an adjustment is required in the event that the transfer pricing documentation is prepared reasonably or the adjustment is immaterial in the context of the multinational enterprise as a whole. This would encourage taxpayers to complete the documentation reasonably and therefore reduce the questions a tax authority would need to ask. It would also discourage proposed adjustments to the pricing by tax authorities where there is no evidence to support such an adjustment.

As stated in chapter 1 of the OECD guidelines, transfer pricing is not an exact science. As such, it should be best practice that gross negligence or evasion should be the only grounds for criminal proceedings. This would encourage more participation in the setting of transfer pricing by employees of the taxpayer outside of the tax department.

*Other mechanisms or issues relevant to the administration of transfer pricing and/or to prevention and resolution of transfer pricing disputes for which guidance should be developed as part of the revision of Chapter IV*

ICC considers there to be merit in exploring the possible introduction of other alternative methods to approaching the administration of transfer pricing and/or the prevention and resolution of transfer pricing disputes. One possible avenue for further exploration in this context would be to consider the possibility of the TP Guidelines being amended to include materials concerning the OECD's 'International Compliance Assurance Programme' (***ICAP***) (should this programme prove to be successful after the initial pilot that began in January this year). While ICC recognises that the ICAP programme is still a pilot programme, ICC believes that the inclusion of information about ICAP would help to facilitate participation by a wider spectrum of tax administrations and taxpayers. For example, a summary of the ICAP process and its key features could be included in Chapter IV, with the ICAP handbook itself either being appended to the TP Guidelines or hosted on the OECD's website as an evolving document that expands on the core principles set down in the revised Chapter IV.

Moreover, it is apparent to ICC that there is a vast array of existing OECD documentation and guidance around various matters relating to or concerning transfer pricing compliance and/or dispute resolution. These include, for example, handbooks and guidance on tax risk assessment in the country-by-country reporting context, as well as the OECD report on 'Dealing Effectively with the Challenges of Transfer Pricing'. ICC suggests that these materials should be either appended to the TP Guidelines, or that comprehensive cross-referencing be included in the TP Guidelines so that all the related practical guidance on compliance and dispute resolution can be accessed through referencing the TP Guidelines (which would function as a single repository of that information).

There are a number of best practices set out in the final report to Action 14, including the commitment to resolve MAP cases within an average timeframe of 24 months and the timely and complete reporting of MAP statistics. It would be extremely helpful if these could be extended to the APA process so that the advantages of APAs, including certainty for both the taxpayer and tax authority, as well the reduction in transfer pricing audits could be enjoyed even more frequently.

*Conclusion*

ICC welcomes the OECD's decision to revisit the provisions of Chapter IV of the TP Guidelines and believes that significant improvements can be made to that Chapter along the lines of the above considerations. It would be helpful to understand from the OECD exactly how and when the revisions are envisaged to be introduced into the existing TP Guidelines (and when the OECD intends to produce a consolidated version of the updated TP Guidelines). ICC remains available to provide further input and expertise to support the future steps of the process. ICC welcomes and encourages the OECD's continued engagement with the business community in order to address pragmatic and effective approaches.

**ANNEX I**

ICC considers that some lessons can be drawn from the approach of the IRS, which has (in large part due to the success of the APA programme) often used various non-transfer pricing practices to approach examinations that have a material transfer pricing element. These practices include the following:

*Accelerated Issue Resolution*
Accelerated Issue Resolution is a procedure by which a settlement for years under audit can be applied to years for which returns have been filed, but that are not under audit. Its purpose is to accelerate the process by which issues currently under examination (and which are also present in later tax periods) can be resolved for all years up until the last year for which a return has been filed.

*Delegation Order 236*
Under this rule, various grades of IRS staff are provided with certain authority to settle 'rollover' and 'recurring' legal (as opposed to factual) issues, provided the same taxpayer has already obtained a settlement with the IRS Office of Appeals in a previous or subsequent tax period on the same issues.

*Simultaneous Appeals and Competent Authority Procedure*
In general, it is possible for a taxpayer that files a request for competent authority assistance to also (at the same time or at a later date) request the IRS Office of Appeals to consider the issue that is being addressed at competent authority level. The procedure is optional and taxpayer initiated. It is intended to allow taxpayers to request the transfer of outstanding issues to the IRS Office of Appeals, while at the same time enabling other issues to continue to be developed by the other IRS team (thereby saving time for both the taxpayer and the tax administration by ensuring teams can work simultaneously).

*Pre-Filing Agreement Programme*
The IRS offers a facility for taxpayers to seek 'pre-filing agreements' on certain factual and legal issues. Initially, the pre-filing agreement programme was limited to factual-related issues, such as asset allocation, valuation of assets, R&D credits, valuation of inventory and similar matters. It was subsequently expanded to include a significantly wider spectrum of issues, including international matters. Its purpose is to secure agreement on technical issues in a cooperative environment, following acceptance into the programme and ahead of the filing of the returns for the years in question.

*Industry Issue Resolution Programme*
The IRS runs this programme to provide tax dispute resolution on an industry basis. The programme can be applied to taxpayers seeking pre- and post-filing resolution of frequently disputed tax issues, and has been successfully applied across a range of industries.

*Compliance Assurance Process*
The Compliance Assurance Process is designed to allow large taxpayers to achieve real-time audits of issues before their returns are filed. It is in many respects similar to the Pre-Filing Agreement Programme described above, and operates as an 'invitation only' programme that aims to reduce taxpayer burden and uncertainty while giving the IRS assurance around accuracy of tax returns in real time.

*Comprehensive Case Resolution Programme*
The IRS runs a comprehensive programme for the resolution of multiple tax issues across various stakeholder groups. The purpose of the programme is to enable taxpayers and the IRS to work together to resolve all open issues for all open tax years (whether currently or previously under examination). The underlying principle of the programme is a cooperative effort between the taxpayer and the tax administration.

*Mediation*
Mediation can in certain circumstances be requested by the taxpayer vis-à-vis the IRS Office of Appeals. Under a mediation procedure, the IRS and the taxpayer will attempt to reach a negotiated settlement, with the assistance of an objective and neutral third party (acting as a mediator, and not as an arbiter).