Crowe Horwath™

Studio Associato Servizi Professionali Integrati
Member Crowe Horwath International

Joseph L. Andrus
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration
OECD

14 September 2012

Comments on the OECD Timing Issues Draft of June 6, 2012

Dear Mr. Andrus,

We are pleased for the opportunity to submit our comments on the subject matter. Different approaches on comparability analysis may cause double taxation issues by also potentially increasing further the level of complexity that transfer pricing compliance has reached in the latest few years due to the mounting level of attention by tax authorities in more and more Countries.

The *ex-ante* setting and the *ex-post* setting approaches have their own pros and cons and, indeed, may perhaps be more appropriate in different circumstances depending on facts.

Transactions subject to transfer pricing adjustments have different nature. Lump-sum sales of intangibles or real estate do differ from on-going sales of commodities or consumer products. Long-term turn-key projects do differ from supply of routine services.

As a rule, third parties do agree prices in advance. Third party transactions, however, may also include price adjustment mechanisms to reflect unexpected increase of costs of raw materials, for example, energy, oil, and any further element that may significantly affect respectively the cost and return on the transaction. Besides, statutes or general principles of commercial laws in various Countries do include specific rules entitling one party to obtain compensatory adjustments where the counterparty may have benefited from so-called substantial unfair enrichment.

Furthermore, transfer pricing policies have different features and characteristics. Traditional transaction methods do differ significantly from transactional profit methods. *Ex-ante* approaches may simplify compliance management if transfer pricing policy is based on budget data by not requiring year-end adjustments that may be necessary by applying the *ex-post* approach. Any year-end adjustment also gives rise to customs duties, VAT and other potential issues.

Because of the variety of scenarios that may arise as a matter of fact, we wonder whether an absolute and unitary approach by all Countries to the *ex-ante vs ex-post* dilemma in all circumstances would indeed be the most appropriate solution. Facts and circumstances may be such that different approaches may be appropriate depending on them.

The choice between price setting and price testing by MNEs should therefore ideally be respected in the various Countries if the overall specific group policy is consistent with the nature of the underlying transactions, contractual terms, market practice, transfer pricing methods, or is applied consistently throughout the years, regardless of the standard approach adopted by the tax authorities of each country as a rule. In particular, if an MNE applies the same method consistently for years, the impact of the application of the other approach by the Revenue should only have a limited effect, often only in the nature of a timing difference, particularly where low-risk recurrent activities are benchmarked under the TNMM method.

Rather than leading to a tax adjustment based on the overall Country tax policy about the setting vs testing method, the Revenue in any given Country may use its own customary standard policy as a risk assessment tool for selection of audit cases to be subject to in-depth transfer pricing review.

If no major discrepancies are identified or no additional tax costs would arise taking into account the level of tax paid by the group in the other Country, tax authorities may surrender any further audit action on the basis of the overarching simplification principle, also to prevent costs and expenses of any MAP proceedings that will likely not lead to additional tax collections for both Countries together.

If major discrepancies arise from the application of both approaches, the consequential in-depth investigation should analyze the consistency of the MNE's overall transfer pricing policy throughout the years and their coherence with the underlying economic and contractual terms of the transactions under scrutiny.

In respect of other transfer pricing aspects, in particular with reference to the recognition of the actual transaction undertaken, paragraphs 1.64-1.69 of the 2010 TP Guidelines do allow for disregarding transactions only in exceptional scenarios characterized by inconsistency between form and substance or abnormal conduct of the group companies. Similar principles do apply with respect to intangibles when valuation is highly uncertain at the time of the transactions as per paragraph 6.28-6.35 of the Guidelines (paragraph 171 ff. in the June 6, 2012 Intangibles Draft).

We wonder if consensus may be reached amongst the Countries by applying an analogous underlying principle that would entitle the tax authorities to challenge the timing approach chosen by an MNE only in exceptional scenarios whereby, for example, either an *ex-ante* setting or an *ex-post* testing policy as outlined in the MNE's transfer pricing reports and implemented in the contracts is contradicted by the actual conduct of the companies or an *ex-post* testing approach would be more coherent with the underlying transaction, eg, a long-term turn-key contract whereby price adjustments are the norm, and limited to scenarios whereby there is a material difference for multiple years.

By applying analogous principles to the ones under paragraphs 6.28-6.35, an *ex-ante* setting policy would be disregarded in favor of an *ex-post* testing approach, or vice versa, only if, taking into account the specifics of the transactions at stake, third parties would have included price adjustments in their terms of agreement or not.

Keeping a flexible approach on the *ex-ante* vs *ex-post* dilemma could also provide benefits to both parties in order to reach settlements on the transfer pricing if the policy is challenged from other standpoint. We have experience of scenarios where the *ex-post* testing approach, as identified as the most appropriate in the circumstances, allowed to reach a settlement equitable to taxpayer and the Revenue in audit scenarios whereby *ex-ante* setting approaches had initially been applied by both parties to benchmark the annual results with significantly different results.

* * *

Thank you again for the opportunity to participate in the discussion on the subject matter.

Sincerely,

Gaetano Pizzitola
Head of Cross-Border Tax Services
Crowe Horwath Italy

Fabio Zampini
Cross-Border Tax Manager
Crowe Horwath Italy