ICC INTERNATIONAL CHAMBER OF COMMERCE The world business organization

Commission on TAXATION

ICC Comments on the 22 June 2017 OECD Discussion Draft: Revised Guidance on Profit Splits

The International Chamber of Commerce (ICC), as the world business organization speaking with authority on behalf of enterprises from all sectors in every part of the world, welcomes the opportunity to comment on the OECD Discussion Draft on the Revised Guidance on Profit Splits (22 June – 15 September 2017) (the "2017 Current Discussion Draft").

ICC commends the work of the OECD in the current Discussion Draft which reflects an appropriate level of evolution from prior drafts and inputs from a wide range of commentators. The alignment of value creation and profits, so long as truly based on the touchstone of the arm's length standard, is an important step in implementing the BEPS measures.

In view of the Country-by-Country reporting requirements spreading across the world, as well as the implications of the Multilateral Instrument, it is widely believed that there will be an ever-increasing focus of tax administrations on protecting their respective tax bases via examination of transfer pricing, permanent establishment (PE), and related matters. Typically, multinational enterprises (MNEs) can be expected to utilize one-sided transfer pricing methodologies while tax authorities are likely to at least consider two-sided methodologies. This, in turn, can be expected to lead to a proportional expansion of disputes and resultant controversy. Accordingly, it is critically important for all parties for the criteria of value creation and profit/loss alignment to be defined as clearly as possible.

Our comments on the 2017 Current Discussion Draft follow:

A. Specific Questions for Commentators: The areas upon which input was specifically requested follow with our comments:

1. *The discussion draft addresses situations in which profit splits of anticipated profits or profit splits of actual profits are appropriate. Where it is established that the transactional profit split is the most appropriate method, please comment on the factors which should be taken into account in determining whether a profit split of anticipated profits or a profit split of actual profits should be used.*

   ICC Comment: The factors should reflect those elements that unrelated parties would take into account. The 2017 Current Discussion Draft at ¶ 52 properly notes the potentially critical role of data from uncontrolled transactions, including JV, licensing, manufacturing, or other agreements ("Uncontrolled Data"). In our experience of involving MAP, APA, and other transfer pricing matters, such data is often available to provide guidance. In every case, efforts should be made to locate and utilize such data.

2. *A number of profit splitting factors are addressed in the discussion draft. Comments are particularly invited on:*

   a. *Whether the existing references to capital or capital employed as a potential profit splitting factor in the current guidance should be retained, and if so, what factors need to be taken into account for its selection and application as a reliable profit splitting factor.*

   ICC Comment: It is our view that capital and capital employed can be important determinative factors and, as such, the references should be retained. However, it is not necessarily the case that capital will be solely allocated to the specific transaction. For example consider the simple circumstance in which one party to a transaction will dedicate a portion of production assets, or a portion of production capacity to the transaction. In such a case the appropriate measurement of assets dedicated to the transaction will be an important determinative factor. Since the proper allocation of capital can be a subjective factor, the guidance should make clear its importance as a profit splitting factor should be proportional to its relationship to underlying risk or intangible factors. Where possible, the demonstration of such relationship may be useful.

b. *Should headcount of similarly skilled and competent employees be included as a potential profit splitting factor, and if so, in what circumstances would it be relevant?*

ICC Comment: Yes, however it may be useful to emphasize that these factors may only be useful to the extent they are proportionally linked or correlate with the profit potential of the transaction under consideration. Further the concepts of skilled and competence can be subjective and may not be uniformly agreed upon. Additionally it may be necessary to establish appropriate weighting amongst different pools of employees and between different profit split factors to ensure a proper delineation of value creation. Again, where possible the demonstration of the relationship or rationale underlying this relationship ought to be included in the associated documentation.

c. *Given the existing guidance in Chapters I and IX of the Transfer Pricing Guidelines, should adjustments for purchasing power parity be made for profit splitting factor amounts, and if so, in what circumstances?*

ICC Comment: Purchasing power parity" can be viewed in a similar context to currency in that both may impact the measurement of the contributions of parties to a transaction. Examples can be cited where contributions are measured on the basis of value and a parity adjustment may not be required, as well as measured on costs where relative cost differentials are not the fundamental value driver, and adjustments required. . In the latter, as noted in D.6.2 of the guidelines parity is often viewed by developing countries as a local intangible asset. Accordingly, it would be appropriate to provide that in such cases a parity adjustment may be appropriate to the extent of its proportional relationship to risk or unique and valuable intangibles is established .

d. What other profit splitting factors should be included in the guidance, and in what circumstances?

ICC Comment: the ICC would recommend the following additional considerations in respect of profit splitting factors:

i. In view of the availability of Uncontrolled Data, it would be appropriate to require that a requirement for use of the transactional profit split include an explanation of the availability of such data.

ii. In considering the application of the transactional profit it is important to recognize that independent parties may measure the full benefits with reference to factors outside of the profit arising from the transaction and may agree to a split of profits different form that implied by the value of direct contributions. Examples might include the circumstance in which the transaction involves a complimentary product, access to a broader customer base, opportunities for risk diversification, or the development of successor technologies. While the guidelines emphasize the importance of understanding industry factors and considering fully business circumstances, and explicit reference to such outcomes and the development of examples may be useful in reducing future controversy.

3. *Additional examples of scenarios in which a transactional profit split is found to be the most appropriate method due to the high level of integration of the business operations are sought, together with an explanation as to the reasoning thereto.*

ICC Comment: In prior versions of the profit split discussions drafts, as well as the overall discussion of Actions 8 – 10, the role of value chain analysis has been highlighted. This element is only lightly addressed in the 2017 Current Discussion Draft. It would be helpful for the final version to include a detailed example of a value chain situation with resultant transactional profit split analysis. ICC would be pleased to cooperate in the development of such an example, reflecting experience in actual case resolution. We note that a value chain analysis may only be an appropriate method in particular circumstances and it may be an unsuitable method in other circumstances.

B. Additional Comments:

1. As stated in the Guidelines, for the most part, the arm’s length principle does not require the application of more than one method (to evaluate a transaction) and ICC agrees the use of more than one method ought not to be necessarily be required. Nonetheless, in our experience in planning, documentation, and controversy contexts, transactional profit split analysis may be used as a means of assessing the strength of the positions of MNEs or tax authorities, as the case may be. To the extent, such testing or secondary analysis has been considered its inclusion in the documentation of MNE’s or positions taken by tax authorities may be useful. Such analyses may be additionally valuable in assessing the implications of Country-by-Country documentation.

2. The discussion draft at ¶ 67 provides that where location savings are retained and included in the profit to be split, the manner in which to allocate such savings should take into account the guidance provided in D.6 of Chapter I. Examples demonstrating the proportion of the location savings to be included and the manner of allocation in the context of a profit split would be helpful.

3. The discussion draft in various instances discusses the importance of weighting of factors in the application of a profit split. ICC recommends that while not prescriptive, the examples in Annex 1 be expanded to demonstrate the application of value and risk weighting of profit split factors,.

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Founded in 1919, and with interests spanning every sector of private enterprise, ICC's global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.