CONFEDERATION FISCALE EUROPEENNE

Opinion Statement FC 12/2016

on the OECD Public Discussion Draft (BEPS Actions 8-10)

Revised Guidance on Profit Splits

Prepared by the CFE Fiscal Committee

Submitted to the OECD in September 2016

The CFE (Confédération Fiscale Européenne) is the umbrella organisation representing the tax profession in Europe. Our members are 26 professional organisations from 21 European countries with more than 200,000 individual members. Our functions are to safeguard the professional interests of tax advisers, to assure the quality of tax services provided by tax advisers, to exchange information about national tax laws and professional law and to contribute to the coordination of tax law in Europe.
The CFE is registered in the EU Transparency Register (no. 3543183647-05).

We will be pleased to answer any questions you may have concerning CFE comments. For further information, please contact Piergiorgio Valente, Chairman of the CFE Fiscal Committee, or Rudolf Reibel, CFE Tax Policy Manager, at brusselsoffice@cfe-eutax.org.

Introduction

This Opinion Statement relates to the OECD Discussion Draft "*Revised Guidance on Profit Splits*"[1] on BEPS Actions 8-10 ("*Assure that transfer pricing outcomes are in line with value creation*"), released on 4 July 2016, and follows up on CFE's previous Opinion Statement issued on this subject-matter[2].
The OECD´s questions are printed in grey, while our answers are printed black.

1. General comments

CFE welcomes OECD efforts and initiatives aimed at improving guidance on the transactional profit split method.
Although we agree that today integrated global value chains play a key role, and that multinational entities (MNEs) quite often perform inter-related functions and activities while jointly controlling the risks associated to such functions, we also foresee some difficulties on the proper checking of the allocation key by MNEs and tax authorities.
Still, we have some concerns as to the practical and consistent implementation at worldwide level of profit splits by different tax authorities and different companies, and we fear that the latter may become a further point of dispute and debate with an increased risk of double taxation, causing mutual agreement procedure (MAP) cases to become even more difficult.
We are also concerned with the likelihood and risk that tax authorities might opt to apply the profit split method based on the analysis of the brief value chain overview reported in the country-by-country reporting document, or that they might start challenging the transactional net margin method (TNMM) in their audit activities.

2. Specific questions raised by the OECD

Section C1 (General Considerations on Transactional Profit Split Methods)

Questions:

1. Comments are invited on the usefulness of the explanation of and of the guidance on transactional profit splits of anticipated profits. In particular:
1.1. Is the distinction between transactional profit splits of anticipated profits and transactional profit splits of actual profits clear?

CFE welcomes the distinction between the two approaches, as well as any guidance that ensures further certainty and clarity to the current guidance. However, further guidance is definitely still needed on this subject.
While the Draft does provide some clarifications stating that the most appropriate method is to be applied on a factual basis of the specific case at issue, it would be rather useful if clear indications were

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[1] http://www.oecd.org/tax/transfer-pricing/BEPS-discussion-draft-on-the-revised-guidance-on-profit-splits.pdf
[2] CFE Opinion Statement FC 4d/2016 on Transfer Pricing and value creation (Action 8-10): final BEPS Recommendations (http://www.cfe-eutax.org/node/5136).

set out for cases in which some “ordinary/routine” profits were to be offset in one manner, while allowing any residual profits to be subject to one or the other kind of profit split method.

CFE is concerned about any decision to include specific and rigid allocation keys and weightings to be used for new business models for the future (not taking into consideration the differences between industries and business models).

1.2. Is the distinction between the two profit split approaches described useful?

Please see our reply above.

2. *Comments are also invited on the link between integration of business activities (and thus the sharing of risks) and the appropriate application of a transactional profit split of actual profits.*

This entire subject-matter is rather complicated. It is our understanding that any guidelines ought to duly consider and acknowledge that there will never be an “absolute” comparable in case of related-party transactions since, in order to aptly conclude whether a profit split method is actually suitable (or not), the negotiating power between the two related parties should also be taken into due consideration (as it plays an important role). As such, in order to actually establish whether a profit split method is actually suitable (or not), the two related parties will necessarily be required to enter into a negotiating power relationship and any guidelines related to such issue should bear such significant aspect in mind

In addition, we fear that the term “integrated” could be interpreted in a broad sense, including cases in which the profit split method should not apply.

Section C2 of the Discussion Draft - Strengths and Weaknesses in a Nutshell

3. *Are the strengths and weaknesses of the transactional profit split method appropriately captured and summarised?*

In our opinion, more details and further elucidation would be welcome on the practical aspects and the difficulties involved when applying the profit split method/s, since such aspects have not been addressed in sufficient detail within the Draft. Further details are essential in view of the several difficulties entailed in the identification process of profits and/or losses to be split.

We welcome the acknowledgment on paragraph 15 of the Discussion Draft on the increase of compliance burdens falling on companies, and on the difficulty of collecting, interpreting and managing data.

4. *Do transactional profit splits of anticipated profits and transactional profit splits of actual profits have different strengths and weaknesses? If so, what are they?*

A weakness of transactional profit splits of anticipated profits is linked to the uncertainty involved in the fact that profits are not actual. Accordingly, such uncertainty is not foreseen in transactional profit splits of actual profits.

C.3 Most Appropriate Method

6.The discussion draft introduces the sharing of economically significant risks as a factor which may indicate that a transactional profit split of actual profits may be the most appropriate method.

6.1. Do commentators have any suggestions for clarifying the notion of risk sharing in this context?

6.2. Do commentators find the draft helps to clarify the circumstances where the transactional profit split method is the most appropriate method? Please provide explanations and/or examples supporting your views.

Preliminarily, a clarification should be provided as far as the notion of "*economically significant risks*" is concerned. A risk should be considered "*economically significant*" only if it has a relevant impact on the party to be determined according to both quantitative and qualitative criteria.
In determining such criteria, the unique and valuable contributions to a transaction should also be taken into consideration. The absence of comparables should not justify the decision for selecting the transactional profit split method.

Section C.3.1 High Integration Level of Operations

8. Is the distinction between parallel and sequential integration of business operations a useful refinement in determining when the transactional profit split method is likely to be the most appropriate method?

We, again, foresee some difficulties with regard to the practical implementation of the provisions.
It is our understanding that taking into consideration the complexity of today's business models, the basis for the selection of the method should consider the broad analysis of specific facts and circumstances - parallel integration should not immediately justify the application of the profit split method.

Section C.3.2 Unique and Valuable Contributions

10. Comments are invited on the relationship between the making of unique and valuable contributions by both (all) parties to a transaction, and the sharing of economically significant risks.

It is our understanding that further guidance will be needed on this specific subject matter (although we believe that it should not be overly prescriptive in order to allow practical implementation). As the Draft at issue clearly states – and understandably so – valuable and unique contributions represent a most fundamental (re)source that creates economic advantages and consequently means that the sharing of more and considerable risks is to be expected; as such, the applicable methods would be on a profit split basis. The above issues require, in any case, more detailed guidelines specifying that only such profits, in excess of profits arising on routine functions, qualify for the application of the profit split method/s.

Section C.3.3 Group synergies

12. The Final BEPS Report on Actions 8-10 noted that group synergies were to be addressed in the guidance on profit splits. The approach taken in this discussion draft is to make reference to the incremental or marginal system profits arising from the group synergy, which would then be shared amongst the relevant associated enterprises. The analytical framework suggested in the draft, based on an accurate delineation of the actual transaction, would not support the combining and splitting of total system profits on the basis of group synergies alone. Comments on this point are invited.

Considering that synergy is the ability of a group to outperform even its best individual member, we welcome the approach to make reference to the incremental or marginal system profits arising from the group synergy. The fact that we have Group synergies do not automatically mean that we should consider using the profit split method. Group synergies may arise without the degree of integration that would require the use of a profit split methodology.

Section C.4 Guidance for Application

15. What further guidance or clarification of existing guidance would be helpful in these sections? Please provide practical examples in support of the response.

Section C.4.1.2 discusses residual analysis. It should be made explicit that the profit split method only applies to those residual profits over and above compensation for routine functions.

Section 4.4 provides guidance on actually splitting the profits. We note that there are few changes from the guidance already in place.

16. The discussion of profit splitting factors sets a requirement that the factors must be capable of being measured in a reliable and verifiable manner. Do commentators believe that useful ways of splitting profits have been excluded? If so, please describe these factors and explain how they meet the requirement of reliable and verifiable measurement.

As previously stated, CFE fears the inclusion of a too rigid form of allocation keys.