To: United Nations
From: Repsol, S.A.
Date: 02/28/2014

Comments on the "United Nations Practical Manual on Transfer Pricing Countries for Developing Countries"

REPSOL appreciates the opportunity to contribute to the ongoing discussion on the revision of the "United Notions Practical Manual on Transfer Pricing for Developing Countries".

Here are our comments:

In order to improve the debate we think that it is important to point out that as a common issue along the document, there is a confusion between the pure concept of transfer pricing, understood as the price setting process for goods and services between controlled (or related) entities within an enterprise, and the use of transfer pricing technics for defining tax optimization strategies.

As a general rule, MNEs use their transfer pricing policies for organizing their business (and the remunerations due by the transactions arising from these business activities) across different jurisdictions and not to erode tax bases. In this regard, setting up transfer pricing policies and document them can be helpful both for taxpayers and Tax Authorities as long as legal requirement to do so are kept at reasonable levels.

In this context, the Manual majorly follows the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Authorities", which can be seen as a good chance for the participating countries to homogenize transfer pricing regulations worldwide. It is essential that Governments and Tax Authorities, both in developing and developed countries, commit to converge to a common ground so that taxpayers administrative burden is not multiplied when operating in different jurisdictions and double taxation situations are not generated due to mismatches in local regulations.

CHAPTER 1

Paragraph 1.2.3.

Under specific situations of double taxation, States should commit to make all the efforts needed in order to eliminate double taxation when such double taxation has been due to transfer pricing adjustments made by one of the states. The states should give tax relief to the taxpayer under the application of international mechanism to eliminate double taxation (Arbitration Convention, bilateral tax treaties, etc.).

Paragraphs 1.2.4 – 1.2.13

It is important to highlight that transfer pricing should not be described as a means to reach to a tax efficient position for multinational groups.

Transfer pricing policies need to be established within multinational groups in order to coordinate and consolidate pricing and financial strategies, but it does not necessary result in profit shifting and tax base erosion. The location of MNEs' businesses is usually not a matter of tax issues. It usually depends on the needs and business opportunities of each particular sector.

In fact, MNEs usually tend to align the taxes paid in each country with the level of economic development of the country in question, so that the presence of the MNE in the country contributes to the economic development of the country, instead of harm its growth.

Paragraph 1.3.10

With the aim of clarifying the concept of intra-group services, it has been included a non-exhaustive list of activities and costs that can be considered as incurred for the benefit of the parent company.

(see Appendix 1).

Paragraph 1.4.11.

Almost all of the multinational groups work with and collaborate with third parties at any moment of its value chain, that is reason why the utilization of non-arm's length prices in intra-group transactions might have a negative impact in an overall financial consideration for the multinational group.

Paragraph 1.7.16.

Transfer pricing consists on fixing the prices of controlled transactions, that, according to the arm's length principle, should be similar to the prices agreed in comparable circumstances by third parties. Therefore, as long as by definition, transfer prices should comply with the pricing standards generally established and approved by the market, transfer pricing could not be defined as a *"zero sum game"- a situation in which the gain of taxable profits by one jurisdiction must be matched by a loss by the other jurisdiction.* Otherwise, business practices and market prices should always be considered as a *"zero sum game".*

CHAPTER 3: GENERAL ENVIROMENT

As stated in paragraph 3.1.5 there is no "template" or model legislation that works in every situation. However, countries should commit to develop a coherent and homogenous transfer pricing regulation aimed at avoiding unnecessary administrative burden for taxpayers as well as double taxation situation. So it is important to look at OECD recent work on this matter.

Paragraphs 3.2 and 3.3

The arm's length principle must be recognized by every country as the general principle assembling transfer pricing regulations. Nevertheless, the existence of different approaches to implement this principle must ensure that no unfair situations are generated due to countries defining "associated enterprises" or "related party transactions" distinctively. A consistent approach towards these concepts is essential to avoid mismatches that usually lead to double taxation. In particular, a general consensus on the 50 per cent shareholding threshold as the degree of participation required for "associated" status would be a good measure in order to exclude from transfer pricing obligations many transactions currently regarded as related that in fact have not such nature.

Paragraph 3.4

With regard to the choice of transfer pricing method, we appreciate the alignment of the UN Manual with the OECD approach in the sense of not recognizing a hierarchy of methods; nevertheless, this measure should also be adopted by the respective local transfer pricing regulations, being most appropriate to analyze, on a case by case basis, which the most appropriate method in every situation is suitable, considering the particularities of the transaction.

Paragraphs 3.5

We agree with the problematic identified under paragraph 3.5 when for a given transaction, there is a lack of independent comparables. In order to mitigate excessive burden for the taxpayer, it is critical that these situations are specially considered by admitting alternative analysis to prove that prices are set on an arm's length basis.

Paragraph 3.7

The use of the "presumptive" approach to assess an arm's length remuneration must be exclusively kept as a last resort and only in those cases where the taxpayer fails to provide valid transfer pricing documentation.

In this regard, it is essential to have transparent comparables in use by Tax Authorities and taxpayers alike. . Both MNEs and Tax Administration should have the same tools available when addressing transfer pricing issues.

Paragraph 3.8

The use of the safe-harbours rules could be an adequate measure in order to lighten the administrative burden when preparing transfer pricing documentation and to facilitate control by Tax Administrations.

Paragraph 3.9 and 3.10

When designing their local transfer pricing regulation, developing countries should be aware that if adjustments are performed when assessing related party transactions (either locally or in a foreign country), the system shall be ready to perform the corresponding adjustment on the other side of the transaction, so that double taxation is not generated in the taxpayer.

In this regard, the impulse and development of MAPs would be very helpful. Furthermore, the inclusion of arbitration clauses should be an objective of developing countries when negotiating Double Tax Treaties, to ensure that double taxation is effectively eliminated.

On the other hand, APAs regimes are always welcomed by MNEs, since they allow securing *ex-ante* the performance of related party transactions with the developing country and thus it incentives investment. A proper APA regime also permits the Tax Authorities to know in advance the transfer pricing policies designed by the MNEs, prior to tax audit, so it can be seen as a win-win situation. In this context, the roll-back system for APAs would increase the certainty for the taxpayer and would avoid litigation.

CHAPTER 5: COMPARABILITY ANALYSIS

We strongly support the idea of paragraph 5.1.3 when it states that "*the mere fact that a transaction may not be found between independent parties does not of itself mean that it is, or it is not, arm's length*". There are many intercompany transactions, especially in complex industries or markets, where no comparables can be found, since they are so specific that only take place within MNEs (often very few ones or even when a market does not exist). Under this scenario, it is essential that Tax Authorities are more flexible accepting alternative analysis, different from the traditional ones, for the taxpayer to prove that those transactions are conducted at arm's length. For example, safe-harbours rules, use of imperfect comparables, use of alternative methodologies and finally, qualitative explanations, when the previous analysis are not possible, to justify that the prices are set at arm's length.

Also very integrated transactions (even involving intangibles), quite usual within MNEs, suffer from this issue. Tax Authorities should be open-minded in order not to expect a traditional comparability analysis when it is not possible.

When dealing with developing countries, Tax Authorities should be ready to accept non-domestic comparables, as nowadays it is really difficult for taxpayers to identify local comparables in certain regions. Commercial databases usually employed to conduct these analyses, lack of appropriate comparables. This should not impede either the Tax Authorities or taxpayers to prove that transactions are conducted at arm`s length without additional or unnecessary efforts. We agree that adjustments to increase comparability should be performed when possible.

The use of alternative sources such as information disclosed by Governments, trade organizations or association should also be proved as valid to conduct analysis. Nevertheless, special care should be taken in order to avoid cherry-picking of comparables.

Finally, Tax Authorities should be aware that, when there is a lack of valid information or the analysis requires disproportionate efforts, taxpayers would turn to global entity analysis instead of a transaction based analysis. A transaction based analysis cannot be required in every situation.

CHAPTER 7: DOCUMENTATION

MNEs involved in global business sometimes conduct related transactions through local companies which share all their costs with independent third parties based on their percentage interest in partnership or consortium agreements.

In these cases, since prices applied to related transactions are accepted and shared with independent third parties, such operations should be considered to have a low tax risk and to be performed at arm's length; therefore, documentation requirements referred to them can be reduce or even waived.

United Nations Practical Manual on Transfer Pricing does not provide any specific guideline regarding the scope of related party transactions to be documented.

In this regard, it should be highlighted that the OECD regime on transfer pricing is designed for the transnational transactions carried out in the core of MNEs and in which the most relevant point is the correct assignment and valuation of tax bases among different jurisdictions.

It should be avoided the indiscriminately application of documentation obligations to all the transactions that enterprises carry out with related parties, whether or not international. Thus, transfer pricing documentation obligations shall only apply to the international transactions carried out among the multinational groups, excluding all the domestic operations in which the risk of loss of collection is not relevant.

Documentation obligations are also applicable to related transactions carried by permanent establishments of foreign companies. However, pursuant to balance tax administration needs for documents and administrative burdens of providing such documentation by tax payers, all permanents establishments of a single foreign company in a given country might be entitled to file a single documentation package in order to simplify documentation obligations.

As regards to the information to be included in the transfer pricing documentation, especially in developing countries, not very used to transfer pricing regulations, it should not be regulated in such an exhaustive manner by means of a mandatory list whose unfulfillment determines formal penalties, so that it is left to the judgment of the taxpayer the documentation that is necessary to justify the market value applied to its related transactions. Consequently, the list of information to be included in transfer pricing documentation shall only be considered as a maximum threshold of taxpayer diligence. There should be a balance between the documentation requirements and the development level of the country so that MNEs are not overloaded with burdens and so the investment in such countries is encouraged.

APPENDIX 1: Shareholder costs

Based on the precedent of previous lists published by the OCDE and the EU Joint Transfer Pricing Forum, following it is included a non-exhaustive list of **activities and costs** that can be considered as incurred for the benefit of the parent company (stewardship/shareholder costs).

However, it should be highlighted that determining which costs should be considered as shareholder costs is not a straightforward issue, it is necessary to perform a **case by case analysis** in order to reach to a conclusion on whether the costs incurred benefit the whole group, benefit only the parent company or benefit certain subsidiaries and, consequently, a service is being rendered.

In the classification of the activities as group services or shareholder activities, certain activities may qualify as mixed activities. Mixed activities are activities conducted by a department within the group which partly qualify as group services and partly as shareholder activities.

1. Costs of activities relating to the juridical structure of the parent company itself such as:

    a. All Presidential costs, including costs of the President's Cabinet.
    b. Costs of the board of directors of the parent company, including the cost of the board of directors' secretary.
    c. Costs for the meeting of shareholders of the parent company, including advertising costs.
    d. Public relations and corporate events costs that help build and maintain relationships with investors. Costs for press conferences and other communications with (i) shareholders of the parent company, (ii) financial analysts, (iii) funds and (iv) other stakeholders of the parent company.
    e. Costs for the issuing of shares of the parent Company and costs related to stock market listing of the parent.

2. Costs relating to reporting requirements of the parent company including the consolidation of reports.

3. Costs for the financial reports of the parent, for the consolidated financial statements of the group and costs for the audit of the parent.

4. Costs related to the study and implementation of the capitalization structure of the subsidiaries.

5. Costs for the increase of the share capital of the subsidiary.

6. Costs of supervision, managerial and control (monitoring) activities related to the management and protection of the investments in participations.

7. Costs of internal audit activities within the group as long as the conclusions derived from the activities are primarily reported to the parent and not to the subsidiary/ies audited.

8. Costs of raising funds for the acquisition of its parent company's participations.

9. Costs to reorganize the group, to acquire new members or to terminate a division, when the objective aimed is to benefit the group as a whole (increase its financial ratios, reduce costs, etc.) and it does not directly benefit one or several subsidiaries.

10. Activities relating to the adoption and enforcement with statutory rules and rules of conduct with regard to “corporate governance” by the parent company itself or the group as a whole, as well as activities related to the establishment of group policies (financial policies, tax policies, human resources policies, insurance policies, etc.).

11. Activities related to the definition, measurement and promotion of the strategic principles in terms of groups’ reputation.