UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

February 25, 2014

U.N. Department of Economic and Social Affairs
Financing for Development Office
2 U. N. Plaza (DC2-21)
New York 10017
Attention: Ilka Ritter (ritter@un.org)

Dear Ms. Ritter:

The United States Council for International Business welcomes the formation by the Committee of Experts on International Cooperation in Tax Matters (the Committee) of a Subcommittee on Article 9 – Associated Enterprises ("Subcommittee") to draft additional chapters to the U.N. Transfer Pricing Manual ("UNTPM") on intangibles, intra-group services and management fees.

USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

USCIB especially appreciates the invitation of the subcommittee to provide input at this early stage. Consistent with this invitation, USCIB's input below, bears in mind the mandate for the Subcommittee, which is that the updated UNTPM will continue to reflect the operation of Article 9 of the United Nations Model Convention and the arm's length principle embodied in it. We are aware that the UN is considering whether it should maintain consistency with the OECD Transfer Pricing Guidelines. We understand the concern of some UN members that they should not be bound by rules that they did not help develop. However, in light of the recent inclusion of the G-20 members in the development of this guidance, that concern should be tempered. Further, consistent rules will go far to ensure a level playing field for multinational enterprises ("MNE's") and tax administrations while minimizing the potential for base erosion on the one hand or double taxation on the other.

Our comments at this early stage are necessarily very general, though it is hoped that the Subcommittee will nonetheless find them to be meaningful in setting a framework for discussions relating to the additional chapters on intangibles, intra-group services and management fees. In addition, we comment below on a particular portion of the discussion of the arm's length standard in the UNTPM.

Intangibles

As a general matter, USCIB strongly supports harmonization of the UNTPM with the OECD Transfer Pricing Guidelines. Any discrepancies – real or perceived -- between the UNTPM and the OECD Transfer Pricing Guidelines would result in the UNTPM becoming a *de facto* second set of rules, contrary to its clearly stated intention. The likely result would be more double taxation disputes that will become increasingly difficult to resolve if the competent authorities cannot even agree as a threshold matter to

a single applicable set of rules. Even more importantly, double taxation would be a certainty absent an operative tax treaty.

While USCIB strongly supports harmonization, exactly how to harmonize the proposed new chapter of UNTPM on intangibles with Chapter VI of the OECD Transfer Pricing Guidelines is far from clear. Chapter VI is currently in the process of being revised in connection with the OECD's longstanding intangibles project, which has since been subsumed into the OECD's Action Plan on Base Erosion and Profit Shifting ("Action Plan"). Commencing work on a new chapter of the UNTPM on intangibles before the OECD's new Chapter VI is finalized later this year unfortunately is chasing a moving target and harmonization will be very difficult to achieve. Moreover, USCIB has expressed serious concerns about a number of the positions taken in the OECD's Discussion Drafts on Transfer Pricing Aspects of Intangibles released on 6 June 2012 (the "Discussion Draft") and 30 July 2013 (the "Revised Discussion Draft," or collectively with the Discussion Draft, the "Discussion Drafts"). While harmonization is an important objective, we believe the Committee should independently evaluate the problematic positions taken by the OECD in the Discussion Drafts. With this in mind, USCIB believes that its prior comment letters on the Discussion Drafts are directly relevant to a proposed new chapter of the UNTPM on intangibles and should accordingly be taken into account by the Subcommittee in drafting this chapter. While we believe our prior comments on the Discussion Drafts are relevant in their entirety to the Subcommittee's current work, there are a few points of particular importance that we believe are worth re-emphasizing.

First, USCIB would re-emphasize our fundamental comment to the Revised Discussion Draft that:

> [a] corollary of the arm's length principle is that taxpayers are allowed to choose their business structure, and it generally cannot be imposed upon them by tax authorities. . . . Any work designed to prevent related parties from engaging in transactions which would not, or would only very rarely, occur between third parties is inconsistent with the arm's length standard and would seem very likely to lead to an untethered ability for tax authorities to interfere in legitimate business structures.

USCIB believes it is paramount that the new intangibles chapter not endorse recharacterization or so-called "special measures" solely because the intangible property at issue is difficult to value or the tax authority believes that unrelated parties would not have entered into the same transaction. USCIB is also concerned about paragraph 5.3.2.25 of the existing UNTPM which states that "the contractual allocation of risk should be at arm's length." This statement is both inconsistent with the arm's length principle for the reasons described above and internally inconsistent with paragraph 5.3.2.23, which correctly notes that "[t]he allocation of risk under a contract will generally be respected by the tax authorities unless it is not consistent with the economic substance of the transaction."

Second, USCIB would urge the Subcommittee to avoid de-emphasizing the role of legal protection of intangibles in favor of less certain notions of "economic ownership." USCIB is concerned that the emphasis on "economic ownership" in paragraph 5.3.2.15 of the existing UNTPM could set the stage for an even greater emphasis on this uncertain concept in the new intangibles chapter. As we noted in our comments on the Revised Discussion Draft, "[t]he advantage to emphasizing legal protection is to avoid discussions about vaguely specified and undifferentiated intangibles or cash flows being included in the valuation of intangibles."

Third, USCIB believes it is important that the new intangibles chapter recognize the importance of the

role of capital, rather than assume that all or most of the profit should be allocated to the entities that perform the so-called "important functions." While an appropriate return to capital placed at-risk in R&D can only be determined under the facts and circumstances, it is important that the guidance recognize the full range of returns that an uncontrolled financier might expect to earn on its capital placed at-risk in R&D, rather than assume or suggest that such returns should be limited to a debt-like return. As we further explained in our comments to the Revised Discussion Draft, "[t]he risk-adjusted returns for investors in intangible development, including returns for "blue sky" R&D, are available and can be quite high. . ."[1]

Finally, USCIB would emphasize that while it might be possible to benchmark an appropriate *expected* rate of return for financing R&D, the essence of bearing a risk dependent on future events is that the actual rate of return may be *higher or lower* than expected. Accordingly, it is important that the new intangibles chapter avoid any inference that a funding entity's *actually realized* return should be artificially limited in contravention of the fundamentally *ex ante* nature of the arm's length principle.

Intra-Group Services and Management Fees:

Globalization has resulted in a shift from country-specific operating models to global models based on matrix management organizations and integrated supply chains that centralize several functions at a regional or global level.[2] As a consequence, there has been a substantial increase in cross-border service and management fees charged between associated enterprises within MNE's.

The fact that the UN has taken up this issue indicates the importance this issue has for both tax administrations and taxpayers, and its role in the discussion of base erosion payments. Action 10 of the OECD's Action Plan also addresses a concern with these charges, which may be one shared by the Subcommittee. Among other actions, Action 10 calls for the adoption of transfer pricing rules or special measures to provide protection against common types of base eroding payments, such as management fees and head office expenses. Although these charges may be viewed as base eroding from the perspective of the service recipient jurisdictions, in fact, these charges frequently originate from significant activities of associated enterprises in higher tax jurisdictions which either require such charge-outs or deny deductions if the costs are not charged out. All deductible payments reduce taxable income somewhere. Payments should not be considered base eroding merely because they are deductible; rather such a determination should depend on whether the payments are non-arm's length. A non-arm's length payment is much less likely if the party receiving the income is also in a high-tax jurisdiction.

In our estimation, the greater issue here is that MNE's are facing an environment in which tax administrators in the predominant service provider jurisdictions are promulgating and strictly enforcing rules that ascribe a very broad definition of a 'benefit' requiring that a foreign associated enterprise bear intercompany service and management fee charges while the predominant service recipient jurisdictions are promulgating and strictly enforcing rules ascribing a very narrow 'benefit' test, in many cases requiring proof of a direct specifically identifiable benefit commensurate with the amount charged. MNE's are now commonly encountering situations in which they are unable to obtain a tax deduction for the cost of management and other services in the jurisdiction incurred or in any other jurisdiction.

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[1] *See* USCIB Comments on Revised Discussion Draft, footnotes 2-4 and accompanying text.
[2] See page 8 of OECD Action Plan on Base Erosion and Profit Shifting.

Clearly, management and other service costs are ordinary and necessary business expenses to a MNE that are properly deductible by ***an*** associated enterprise within a MNE. USCIB welcomes consistent standards at both the UN and the OECD that draw as clear a line as possible for taxpayers to apply to properly deduct inter-group services and management fees in **an** associated enterprise. It matters less to MNE's in which associated enterprise these expenses are deducted so long as these costs are deductible somewhere within a multinational group. In this regard, USCIB continues to support mandatory arbitration as an effective and efficient tax treaty provision to resolve issues of potential double taxation including which jurisdiction ought to bear the cost of these ordinary and necessary business expenses. In addition, consistent with paragraph 1.6.10 of the UNTPM and the recently released OECD safer harbour guidance (Subsection E of Chapter IV), administrative safe harbour rules should be considered. Lastly, as described in paragraph 7.24 of the OECD Transfer Pricing Guidelines, a charge could be determined based on a [reasonable] allocation among all potential beneficiaries of the costs that cannot be allocated directly where a separate recording and analysis of the relevant service activities for each beneficiary would involve a burden of administrative work that would be disproportionately heavy in relation to the activities themselves.

The Arm's Length Principle

USCIB is also concerned about paragraphs 1.10.1 through 1.10.3 of the UNTPM. These sections discuss various challenges facing the arm's length standard without discussing any options to overcome these challenges. USCIB is concerned that this may give the wrong impression that the UN believes that the arm's length standard has been irreparably damaged by these difficult areas of enforcement. This would be confusing and send mixed messages as it would be contrary to the UN's stated position that it endorses the arm's length standard. We recommend either eliminating these sections or modifying them to suggest that nations can minimize the risks posed by these challenges through targeted provisions in their domestic laws or through bilateral or multilateral tax treaties.

USCIB appreciates the opportunity to provide input to the Subcommittee and looks forward to having additional opportunities to provide input as the project progresses.

Sincerely,

William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)

cc: Stig Sollund, Director-General, Deputy Head of the Tax Law Department, Ministry of Finance, Norway, and Coordinator of the UN Subcommittee on Article 9 – Associated Enterprises
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