TAX EXECUTIVES INSTITUTE, INC.

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Andrew Hickman
Head, Transfer Pricing Unit
Centre for Tax Policy and Administration
Organisation for Economic Co-Operation
and Development
Paris, France

Via Email: transferpricing@oecd.org

RE: Public Discussion Draft on BEPS Action 10: Commodity Transactions

Dear Mr. Hickman:

On 19 July 2013, the OECD published an *Action Plan on Base Erosion and Profit Shifting* (hereinafter the Action Plan or the Plan) setting forth 15 actions the OECD will undertake to address a series of issues that contribute to the perception that individual countries' tax bases are being eroded or profits shifted improperly. Pursuant to Action 10 of the Plan, on 16 December 2014 the OECD published a document entitled *BEPS Action 10: Discussion Draft on the Transfer Pricing Aspects of Cross-Border Commodity Transactions* (hereinafter the Discussion Draft or Draft).

The OECD solicited comments from interested parties no later than 6 February 2015. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the OECD's request for comments.

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organisation has 56 chapters in Europe, North and South America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 individual members represent over 3,000 of the largest companies in the world.[1]

TEI Comments

TEI commends the OECD for its work on the application of the arm's length principle to cross-border commodity transactions in the Discussion Draft. The guidance proposed in the Draft is a step in the right direction and relatively non-controversial. The recommendation to use publicly available quoted exchange prices as a comparable is particularly welcome. The Discussion Draft sets forth several issues with respect to cross-border commodity transactions as identified by tax authorities. These include the advantageous use of pricing conventions, significant taxpayer adjustments to the quoted commodity price, and the involvement of limited function entities in low tax jurisdictions. TEI agrees that these issues should be addressed and the approach in the Draft is a good starting point. The Discussion Draft, however, omits other issues that, if neglected, may unnecessarily complicate the application of the new guidance.

Pricing Issues

First, the Discussion Draft does not address the difference between commodities for which actual trading prices are quoted on an exchange – such as the London Metals Exchange or Chicago Board of Trade – and other commodities (bulk traded goods) for which market price indicators are available through pricing agencies – such as Argus or Bloomberg. If a price for a commodity is quoted on one of the various exchanges then a person willing to sell such a commodity has a guaranteed opportunity to sell the goods for the quoted price. In contrast, the prices for bulk traded goods are only available by indirect indications and a person willing to sell the product does not have a guaranteed opportunity to sell the goods for the indicated price. The Discussion Draft conflates these two very different situations without carefully delineating between them and addressing how the arm's length principle may apply in each case.

Market price indicators with respect to bulk traded goods do not reflect the prices of such goods precisely enough to use as a comparable for transfer pricing purposes. They are derived by various direct and indirect means and do not necessarily "generally reflect the agreement between independent buyers and sellers in the market on the price for a specific type and amount of commodity" – as the Draft notes with respect to prices quoted on an exchange.[2] Instead, they may include data and other information from parties not involved in the trades, including but not limited to desired (but not actual) prices advertised by market actors,

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1 TEI is a corporation organised in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).

2 Discussion Draft, p.5.

opinions of analysts, *etc*. The deviation between the price indicators available through pricing agencies and the actual market prices may reach material levels. Thus, while applying the comparable uncontrolled price (CUP) method is appropriate with respect to exchange traded commodities, it may not always be the most reliable transfer pricing method for bulk traded goods where prices are available from a pricing agency.

Another issue with the use of market pricing indicators from pricing agencies is that they usually reflect the prices of "spot" transactions, whereas the majority of bulk traded goods are sold based on contracts with long term commitments. Sellers are typically willing to provide reasonable discounts versus spot prices for such long term commitments, an important pricing factor for these goods. While the Discussion Draft correctly identified several other significant pricing factors, such as specificities of the goods, possible additional processing needed, position in the supply chain, *etc*., this one was omitted.

Another important pricing factor is the necessity to leave an arm's length profit margin for the trading and distribution functions of MNEs. The Discussion Draft implicitly recognises this through references to the position of an entity in the supply chain, but it should be specifically mentioned in the final guidance. In addition, the volume of the contract is another factor that often results or requires a pricing adjustment from those terms that may be publicly available. In sum, TEI recommends that the second to last sentence of paragraph 3 of the proposed additions to be included immediately after existing paragraph 2.16 of Chapter II, Section B. of the transfer pricing guidelines[3] specifically reference the volume, duration, and payment terms as factors that affect commodity pricing. Given the volume of most commodity transactions, even a minimal change in pricing to reflect differences in volume, duration or payment terms can result in material tax adjustments.

Neglecting the above issues may trigger oversimplification in the form of assertions by tax authorities that the sales of commodities and bulk traded goods should "normally" be done with the quoted (exchange) prices or (mistakenly) equivalent price quotes from pricing agencies. This would lead to unrealistic price estimation and not to "creat[ing] greater consistency in the way tax administrations and taxpayers determine the pricing or commodities under the arm's length principle."[4] To avoid this result, the proposed changes in the OECD guidelines should be re-drafted to reflect business realities of commodity pricing in a more precise manner.

The "Deemed Pricing Date"

The Discussion Draft includes a deemed pricing date proposal for commodity transactions in cases where there is an absence of reliable evidence of the agreed pricing date

3 *Id*. at p.6.

4 *Id*. at p.4.

used for transactions between associated enterprises. The Draft's proposal uses the quoted price on the shipment date (incorporating any comparability adjustments) as the "pricing date," which is defined as "the specific date or time period selected (e.g. a specified range of dates over which an average price is determined) by the parties to determine the price for the commodity transactions."[5] The shipping date may generally be a relevant date for commodities commonly priced at the shipping date, but this is not the case for all commodities and thus the recommendation is too specific and limited.

The goal of a deemed pricing date is to remove the taxpayer's ability to selectively manipulate and choose prices to its sole advantage. The recommendation should begin with a statement of principles for picking the deemed pricing date based upon objective, uniformly applied criteria that are consistent with third party pricing conventions for the type of commodity transaction. This would remove the possibility that the parties will selectively choose the most advantageous price on a transaction by transaction basis. The guidance should then reference several possibilities. These should include the average price for the period of the transaction, or specific transaction dates such as date of shipment, date of receipt or date of delivery, whichever is most appropriate with the form of transaction and industry practices. All of these methods remove the ability of the taxpayer to manipulate transfer prices and give both the taxpayer and the tax authorities the flexibility to choose the method that is most appropriate to the actual transaction. The adoption of a single default method is too rigid an approach for the variety of commodities that are traded today.

Documentation Issues

The documentation requirements of a price-setting policy in the case of commodities that are traded at a quoted price, which would implicate the CUP arm's length price, is an important element to be taken into account by tax authorities while performing their transfer pricing evaluations and risks assessments. The Discussion Draft states that taxpayers should include their price-setting policy in their transfer pricing documentation. However, the Draft does not specify the proper place for such documentation in the context of the tiered approach developed under BEPS Action 13. In TEI's view, for countries and MNEs that adopt the tiered approach to documentation under Action 13, the master file is the appropriate place to document an MNE's commodity pricing policy. Such a policy is relevant to providing a high-level overview of an MNE's operations. In fact, including documentation of price-setting mechanisms and application of the CUP method in the case of commodities that are traded at a quoted price in the master file would simplify transfer pricing documentation and would be welcomed by MNEs that regularly produce, purchase, sell, or deal in commodities.

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5 *Id*. at p.6.

Conclusion

TEI appreciates the opportunity to comment on the OECD Discussion Draft under BEPS Action 10 addressing transfer pricing issues for cross-border commodity transactions. These comments were prepared under the aegis of TEI's European Direct Tax Committee, whose Chair is Nick Hasenoehrl. If you have any questions about the submission, please contact Mr. Hasenoehrl at +41 786 88 3772, nickhasen@sbcglobal.net, or Benjamin R. Shreck of the Institute's legal staff, at +1 202 638 5601, bshreck@tei.org.

Sincerely yours,
TAX EXECUTIVES INSTITUTE, INC.

Mark C. Silbiger

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