BEPS Actions 8, 9 and 10: Discussion draft on revisions to Chapter I of the Transfer Pricing Guidelines (including risk, recharacterisation and special measures)
Response by the Chartered Institute of Taxation

1 Introduction

1.1 The Chartered Institute of Taxation (CIOT) is pleased to respond to the public discussion draft published by the OECD in December 2014 entitled BEPS Actions 8, 9 and 10: Discussion draft on revisions to Chapter I of the Transfer Pricing Guidelines (including risk, recharacterisation and special measures).

1.2 We support the aims of the OECD to ensure that transfer pricing outcomes are in line with the economic substance of a transaction including, in particular, value creation. However, we have some general comments regarding the approach being suggested.

2 Part I - revised Section D of Chapter I of the Transfer Pricing Guidelines

2.1 In general the revised Section D of Chapter I of the Transfer Pricing Guidelines (Section D) set out in Part I of the discussion draft does a good job of identifying the circumstances in which to look beyond the contractual documentation in order to determine the appropriate treatment for transfer pricing purposes.

2.2 However, we do have concerns around the circumstances in which it is suggested that an entity, which has a separate legal personality, can be overlooked/ignored. This concept is principally discussed at section D.4. Non-recognition.

2.3 We suggest that the concept of an entity having a separate legal personality is a fundamental legal concept and that the ability of a legal person to contract and take on risk and be rewarded is fundamental to the international trading system.
2.4 There are fundamental legal concepts which mean that ultimately a legal person is responsible for its actions, and that person should not be ignored, except in very limited circumstances. Unless the multinational group is acting in such a way as to deprive the entity of all its responsibilities, the entity must be left with something and must bring something to the transaction – and that something must have a value – even if that value is very small.

2.5 We suggest that unless it can be shown that the involvement of a particular legal entity is, in effect, a deliberate or inadvertent sham – by which we mean that the existence and involvement of the legal entity means absolutely nothing in relation to the transaction, such that it could be removed altogether with no effect, then there must be something that the legal entity is doing, and this will have a value – albeit small in some cases.

2.6 We think that there should be great caution exercised before suggesting that legal entities should be ignored on the basis that they have no purpose in a particular transaction, as to do so undermines the fundamental legal concept of separate legal personality.

3 Part II – Potential Special Measures

3.1 We recognise the perceived need for special measures, but would emphasise that, as noted in paragraph 2 of Part II, the proposed revisions to Section D set out in Part I will address most areas of concern.

3.2 We would like to seek assurance from the OECD, and suggest that it should be made clear in any special measures which are adopted, that special measures are intended to be a back up to the guidance in Section D. We would be concerned if tax authorities were to invoke special measures too readily.

3.3 If amended as proposed, Section D will be very comprehensive and should apply to the vast majority of transactions. However, inevitably, applying Section D to complex transactions will involve some hard work on the part of taxpayers and tax authorities. However, to seek to do so in the first instance should clearly be stated to be the correct approach. Applying Section D is the best way to ensure that the transfer pricing outcomes are in line with economic substance; special measures would always be more of an approximation.

3.4 Thus we suggest that special measures should be viewed as a last resort. To mitigate the danger of special measure become a bench mark or default position for tax authorities, it should be clearly stated that any measures emerging from Part II of the discussion draft should only be invoked following a good faith negotiation between the taxpayer and tax authority regarding the application of Section D.

4 The Chartered Institute of Taxation

4.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes
Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT’s 17,000 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

The Chartered Institute of Taxation
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