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OECD

OECD's Andrus Defends Logic Of MOUs for Bilateral Safe Harbors

PARIS—Multilateral safe harbors are a good idea but could take a long time to work out, so in the meantime, bilateral safe harbors are the best bet to make early progress on simplifying transfer pricing for certain frequent transactions, the Organization for Economic Cooperation and Development's transfer pricing chief said Nov. 12.

Joseph Andrus, who heads the OECD's transfer pricing unit, made his comments on the first day of the organization's Nov. 12-14 public consultation on transfer pricing drafts at the OECD's Paris headquarters.

The conference gathered tax officials from the OECD's Working Party No. 6 on taxation of multinational enterprises to hear and respond to feedback from business practitioners about the discussion drafts on safe harbors and intangibles, as well as on timing issues related to intangibles.

After hearing several business practitioners call for multilateral safe harbors, the OECD official said he understood that businesses want ''absolute certainty.'' In that context, ''some global solutions would be great but [they] take a lot of time and they take a lot of people to agree. So I think the secretariat's view [regarding bilateral MOUs] is that every little bit helps.''

Andrus added that ''at least some of us would be in favor of safe harbor provisions that a number of countries could agree on, and that is on [our] agenda. But don't hold your breath for that to happen in the next month or two. It is unfortunately not the simplest of transfer pricing questions when you start talking to many countries.''

Mostly Favorable. Under a safe harbor approach, if a company shows a profit within a preapproved range, or safe harbor, the tax authority does not challenge the company on its transfer pricing.

Andrus has said the guidelines' current language strongly discourages use of safe harbors because it was written in 1995, when officials feared what could happen if countries worldwide adopted Brazil's much-maligned fixed-margin approach, rather than the OECD's arm's-length approach, to transfer pricing (20 *Transfer Pricing Report* 872, 2/9/12).

The proposed revision would ease the guidelines' existing language to allow bilateral safe harbor arrangements to reduce risk of double taxation and undertaxation but also dissuade countries from taking non-OECD approaches to transfer pricing, he said (21 *Transfer Pricing Report* 353, 8/9/12).

Working Party No. 6 also has published draft memoranda of understanding for country competent authorities to use as models for bilateral safe harbors.

In October Andrus reported he had received ''mostly quite favorable'' comments on the proposed changes to the safe harbor guidelines, although some comments said the proposed MOUs were too restrictive. He said he expected the working party to complete its revision without significant further work (21 *Transfer Pricing Report* 624, 11/1/12).

Allows 'Test Driving.' During the consultation's first session, practitioners mostly welcomed the proposed revision but some criticized its focus on bilateral memorandums of understanding.

Patricia Lewis of Caplin & Drysdale in Washington, D.C., told the consultation that the discussion draft indicates that, ''despite previous reservations, safe harbors today make sense from almost every perspective. Safe harbors, especially bilateral ones, have the potential to be truly transformational to global transfer pricing administration.''

Lewis said safe harbors will help tax administrations and taxpayers deal with acute resource restraints caused by expansion of cross-border trade, as well as growing complexity of transfer pricing requirements, and help eliminate double taxation.

In particular, she said bilateral safe harbors are ideal for the many relatively benign simple cross-transactions for which well-established metrics exist, allowing authorities to focus their resources on more challenging transactions.

''Bilateral safe harbors enable governments and taxpayers to test drive solutions to selected transfer pricing configurations where the values and the trade-offs are known and controllable. If the initial experience is good, the scope can then be expanded,'' said Lewis.

Lewis praised the OECD's safe harbor discussion draft earlier in the year in an article that also explored past resistance to safe harbors (21 *Transfer Pricing Report* 450, 9/6/12).

Matthew Wall, transfer pricing expert for MDW Consulting in Toronto, said the OECD's safe harbor guidance should explicitly say that safe harbors and MOUs are for low-risk transactions, and not to be used for other transactions. This, he said, would prevent a tax authority from applying a low-risk transaction range to a high-value intangible to arrive at a conclusion that a related party had contributed to those high-value intangibles.

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Short-Cut APAs.' Lewis praised the draft MOUs as a ''simply brilliant'' idea to jump-start a bilateral negotiation process that will help ensure an arm's-length result. She said this should ease concerns about ''adverse selection,'' and once in place, bilateral safe harbors can act as a kind of ''class APA [advance price agreement]'' with broad and efficient reach, eliminating double taxation.

She suggested the draft should be revised to bar or limit safe harbors for transactions with tax havens. It also could include language that allows combining safe harbors with the short APA process for unclear cases.

But India's APA program director, Batsala Jha Yadav, expressed reservations about safe harbors functioning as ''short-cut APAs. What is a short-cut APA process and when we are talking about applying safe harbors to low-risk cases, how do we define 'unclear cases' here?'' Yadav asked.

Debate Over Approach. In comments released in October, Tax Executives Institute Inc. warned that few countries are likely to negotiate bilateral MOUs for safe harbors because the process is time-consuming and complex (21 *Transfer Pricing Report* 623, 11/1/12).

At the consultation, An Theeuwes, tax policy manager at TEI, welcomed the draft's focus on using safe harbors for routine tasks, but said safe harbors should be optional. She said bilateral safe harbors could complicate tax compliance for companies, ''given the multilateral character of multinational enterprises' transactions.''

Theeuwes said a unilateral approach is less complicated because it is set in local legislation rather than tax treaties. This approach can be helpful for businesses with centralized activities in one country, because ''it allows a lot of clarity and allows you to focus on certain items. It is also makes audits easier for tax administrations,'' she said.

Lewis called this a ''minority view,'' arguing, ''I don't see why unilateral safe harbors would be any better, from a monitoring perspective. I am optimistic that there is enough hunger for bilateral solutions to minimize multi-jurisdictional controversy.''

Multilateral Approach. Michael Heckel, transfer pricing director at True Partners Consulting International Network, agreed that negotiations for bilateral MOUs could become very expensive for countries. He calculated that, multiplying the three draft MOUs by the OECD's 34 member countries, plus the six emerging economy observer countries on the working party, there could be 120 MOUs in a network.

''And each memorandum of understanding would take a lot of effort,'' Heckel said. He suggested the OECD develop a more standardized solution, using markups and methods aimed at reducing effort. For example, ''a multilateral MOU would allow a lot of countries to join the same solution,'' he said.

Theeuwes agreed that the OECD should consider a multilateral approach.

Arwed Crüger, head of transfer pricing at WTS Tax Legal Consulting, said experience in Germany shows that safe harbors work only if clear definitions, a list of transactions covered, and fixed thresholds for transactions—such as a range—are established.

Crüger also suggested a multilateral approach to safe harbors would be best. He described a hypothetical situation in which the United States and Canada enter into an MOU that prices headquarters services at cost plus 5 percent. Then Germany and Austria enter into an MOU at 10 percent. ''That means a multinational now has four countries that are covered and a lot of countries that are not covered,'' he said.

''I would [suggest] a system where all countries agree on the same margin. Otherwise, it's not a simplification for the multinational,'' he said.

Call Center Hypothetical. Andrus said he has been ''puzzled'' by TEI's comments regarding bilateral MOUs. He described a hypothetical situation in which India and Japan, noting that they have had 32 competent authority arrangements on call centers in India, agree to and publish a bilateral MOU under which ''an Indian call center will earn cost plus 15 percent.''

Then, the United Kingdom, Germany, the Netherlands, and the United States strike the same deal with India, for five MOUs in total. ''Would TEI think that's a terrible thing if that happened?'' Andrus asked.

Theeuwes answered, ''No, that would not be terrible.'' She said TEI hopes the OECD will provide more guidance to allow members to agree early on multilateral approaches, to avoid, as much as possible, the greater effort needed for many bilateral MOUs. ''The point that we were trying to make is try to see the bilateral arrangements as a step-up to the multilateral. So keep the multilateral in mind,'' she said.

'Rough Justice' Objective. Lewis noted that some comments had expressed concerns that the draft MOUs are too restrictive about what kinds of entities and transactions can qualify. Although the drafts were intended only as a starting point for discussions, ''the attempt to isolate the covered transactions for discussion . . . makes the MOUs appear too restrictive. But they need not end up that way,'' she said.

She suggested the OECD aim for ''rough justice, without precision overkill, so that size limits, single-activity requirements, and other limitations could be relaxed.'' Clear metrics need to be established at the outset for this to work, while ''leakage'' concerns could be addressed by adding an anti-abuse provision to the guidelines, she said.

A Canadian delegate to the working party asked whether safe harbors always should be optional. Henry Godé of Grant Thornton Avocats said yes, but that it may be necessary for MOUs to include language similar to what exists for APAs stating that not opting in to the safe harbor does not automatically trigger an audit.

Carol Doran Klein, vice president and international tax counsel at the United States Council for International Business, said the proposed MOUs include many requirements for qualification. ''Obviously if you think you are qualified, and it turns out the country thinks you are not, then you have a very bad result because you haven't done the documentation that you would need to.''

Doran Klein suggested reducing entity qualification requirements. If they are kept, however, ''it is very important to have a process where someone can come in and say, 'I would like to use a safe harbor but it's not clear to me that I qualify, can we agree on that?' ''

By Rick Mitchell

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