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Confederation of Swedish Enterprise - Comments on the OECD Public Discussion Draft entitled: "BEPS Action 10: Discussion Draft on the use of Profit Splits in the context of global value chains" 16 December 2014 - 6 February 2015

The Confederation of Swedish Enterprise is Sweden's largest business federation representing 49 member organizations and 60 000 member companies in Sweden, equivalent to more than 90 per cent of the private sector.

The Confederation of Swedish Enterprise is pleased to provide comments on the OECD Discussion Draft entitled "BEPS Action 10: Discussion Draft on the use of Profit Splits in the context of Global Value Chains" 16 December 2014 - 6 February 2015 (hereinafter referred to as the Draft).

General Comments

The Confederation of Swedish Enterprise appreciates the work by the OECD on the use of profit splits in the context of global value chains. As the global economy develops, the number of ways in which entities can interact with each other within an MNE is increasing and so is the number of ways in which value can be created. This leads to possibilities for MNEs to structure their value chains in many new ways. Due to the integrated nature of many MNE groups and the new ways in which they interact it is often, as acknowledged in the Draft, difficult if not impossible to find perfect comparables, and each case must be analyzed on its own merits and the fundamental distinction between unique and non-unique contributions should be maintained. In such situations the transactional profit split methods may provide an appropriate solution when one-sided methods are not applicable as each party makes valuable contributions to the transaction.

However, the risk of disagreement between tax authorities over which allocation factors to use should not be underestimated. To avoid the risk for increased uncertainty, costly litigation and increased administrative burdens, a profit split method should therefore only be applied where no simpler alternative is available.

In addition, it is of utmost importance that the application of a profit split method is based on the facts and circumstances of each individual case to ensure arm's length outcomes of the application.

It is important to keep in mind the diversity of different MNE groups, also those that are not fully integrated. Any profit split method needs to be developed in a way that it can be applied to any business model. This is especially important considering the constant development of the economy.

Below are our comments to some of the questions posed in the Draft.

Specific Questions

2. What aspects of Scenario 1 would need to be elaborated to determine whether a transactional profit split method or another method would be appropriate in this case?

A thorough functional analysis including functions, assets and risk should be conducted. Such analysis will facilitate the determination on which method is the most appropriate one.

3. Is the application of a transactional profit split method more useful than other methods for dealing with particular aspects of value chains, such as highly integrated functions, and the sharing of risks?

Not necessarily. That would depend on the type of functions and risks. Non-unique contributions should typically be rewarded with an arms-length compensations and not be part of a profit split. In certain situations, when dealing with unique and valuable contributions by group entities however, the transactional profit split method could be appropriate depending on the facts and circumstances of the individual case.

4. What guidance should be provided to address the appropriate application of transactional profit split methods to deal with these aspects of value chains?

The Confederation of Swedish Enterprise does not believe that a profit split method should be applied automatically under certain circumstances as this could lead to arbitrary application of formula approaches and use of hindsight by tax authorities that could potentially lead to more uncertainty and disagreement and unwillingness to invest. The most appropriate method under the arm's length principle should always be used. To automate the application of profit split methods would mean a potential departure from the arm's length principle and increased complexity and risk of double taxation.

Guidance on the appropriate application of profit split methods should include which allocation keys are recommended to share profits, what is meant by "significant integration" and more details regarding in what specific situations the method should be applied.

6. What aspects of Scenario 2 would need to be elaborated to determine whether a transactional profit split method or another method would be appropriate in this case?

A detailed functionality analysis should be conducted to establish where value is created and by which entity. The transfer pricing analysis of a multisided business models should not be any different than any analysis applicable to other types of businesses.

7. Does the way in which "unique and valuable" is defined for intangibles assist in defining the term "unique and valuable contributions" in relation to the transactional profit split method?

Yes, the definition of unique and valuable intangibles does contribute some guidance on what should be considered unique and valuable contributions. Any additional guidance to reach further clarity would however be appreciated. The existence of a unique and valuable intangible should however not lead to the assumption that a profit split should automatically apply.

8. What aspects of Scenario 3 need to be further elaborated in order to determine whether a transactional profit split or another method might be the most appropriate method?

The same answers as to questions 2 and 6 are applicable here. The choice of business model used should not affect how the analysis on most appropriate method is applied.

9. Based on the abbreviated fact-pattern set out in Scenario 3, what method could be used to provide reliable arm's length results to determine the remuneration for Company S? If a transactional profit split method is used, how should it be applied?

If it is assumed that Company S is the only company performing unique and valuable functions, an allocation using a profit split method could be done by first remunerating the routine activities to all parties involved, and then the residual profit could be allocated to Company S. If several companies where performing unique and valuable functions, the residual profit would be shared between these companies.

11. In what circumstances might the application of a transactional profit split method be an appropriate approach for dealing with sharing of risks?

The first step should be to conduct a comparability analysis and determine the risk of each company. If the risk is shared, and the risk would have had impact on the price of the transaction at arm’s length, then a profit split method could be appropriate to allocate the profit.

It is however dependent on the circumstances in each case what kind of contribution the risk represents. Sometimes the risk is a unique contribution that may represent the very essence of a transaction, whereas in other situations the risk bearing is not much of a contribution at all. In cases of multiple unique and valuable contributions consisting of risk bearing, the residual profit could be appropriate to allocate in accordance with a profit split method.

12. Would a one-sided method produce more reliable results?

This is naturally dependent on the circumstances in each case. A one-sided method could be preferable in a situation where the arm’s length profitability of each company can be appropriately determined on a single tested-party basis.

13. What aspects of Scenario 4 need to be further elaborated in order to determine whether a transactional profit split method or another method might be the most appropriate method?

As mentioned before in the answers to question 2, 6 and 8, a complete functional analysis should be conducted.

14. Should the guidance on the scope of transactional profit split methods be amended to accommodate profit split solutions to situations such as those referred to in the interim guidance on intangibles? If so, how?

It is important that the transfer pricing area, even though dealt with in different reports from OECD, is treated as a complete system. This would include making sure that guidance on profit split methods is consistent and coherent with guidance on intangibles.

16. What aspects of fragmentation need to be further elaborated in order to determine whether a transactional profit split or another method might be more appropriate?

When elaborating and determining the most appropriate method, all facts and circumstances in a certain case should be taken into consideration. This assessment could include if the fragmented functions represent non-unique contributions, and for which a one-sided approach would be conceptually more suitable.

19. What aspects of scenario 5 need to be further elaborated in order to determine whether a transactional profit split or another method might be more appropriate?

To determine the nature of contributions from different parties, a functional analysis should be conducted together with an overview of the complete value chain.

20. In what circumstances, if any, might an approach described in the last sentence of paragraph 32 be appropriate?

We agree with the comments made by BIAC.

22. In what ways should the guidance be modified to help identify factors which reflect value creation in the context of a particular transaction? Are there particular factors which are likely to reflect value creation in the context of a particular industry or sector?

This needs to be analyzed on a case-by-case basis. Additional guidance on what factors would better reflect value creation would be very useful when using profit split methods. However, it is difficult to find common features for specific industries as they will mostly depend on the functional analysis and the contributions to value creations made by each party in each specific transactions. Nevertheless, listing examples could serve as guidance.

23. What guidance is needed on weighting of factors?

Since the nature of a profit split methodology is subjective, any guidance on how to weight different factors would mean additional certainty for taxpayers and would therefore be welcomed. However, since profit splits normally deal with unique and valuable contributions, it is hard to see how general guidance in this area could be provided.

24. How can other approaches be used to supplement or refine the results of a detailed functional analysis in order to improve the reliability of profit splitting factors (for example approaches based on concepts of bargaining power,

options realistically available, or a RACI-type analysis of responsibilities and decision making)?

We do not support the establishing of new guidelines in this area as rules based on the concepts in question 24 are likely to lead to formulary apportionment.

26. What specific aspects of transactional profit split approaches may be particularly relevant in determining arm's length outcomes for transactions involving hard-to-value intangibles?

27. How can transactional profit split methods be applied to deal with unanticipated results? What further guidance is advisable?

We agree with the comments made by BIAC on questions 26 and 27.

29. In what circumstances might it be appropriate under the arm's length principle to vary the application of splitting factors depending on whether there is a combined profit or a combined loss?

The Confederation of Swedish Enterprise believes that profit split methodology should be developed in a way that it can deal with both the generation of profits and losses. In the majority of cases, losses and profits are treated and shared in the same way. Adapting different splitting factors for losses and profits would mean a focus on the minority of situations, which could increase the risk of double taxation.

30. Are there circumstances under the arm's length principle where parties which would share combined profits, would not be expected to take any share of combined losses?

This depends on the facts and circumstances of each individual case. Performance based purchase contracts are often restricted to sharing limited profits only but not losses. In other cases, independent parties may agree to share both profits and losses (not necessarily equally). A profit split method should therefore typically also involve a split of losses (although not necessarily 50/50). However, depending on the circumstances it may be reasonable to apply models where losses are assumed by one party in return for a higher residual reward, while the other party is remunerated on a risk adjusted arm's length basis.

31. Paragraph 2.114 of the Guidelines points to some practical difficulties in applying the transactional profit split method. Do those pointers remain relevant, and what other practical difficulties are encountered? How are such difficulties managed?

The difficulties pointed out in paragraph 2.114 of the Guidelines are indeed still relevant and gives a good summary on the practical difficulties that is associated with the application of a profit split method. It is however just a summary of the different challenges for a taxpayer, and given the technical complexity in applying a profit split, the guidelines should be expanded.

On behalf of the Confederation of Swedish Enterprise

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