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BEPS Action 10: Discussion draft on the transfer pricing aspects of commodity transactions

Comments by NERA Economic Consulting

Dear Mr. Hickman,

We would like to thank the focus group for the possibility to provide comment on the discussion draft on transfer pricing aspects of cross-border commodity transactions. The discussion draft provides a summary of some key issues faced by both tax authorities and taxpayers in this context. It also develops further guidance, in the broader context of the application of the CUP method, so as how to assess the pricing date in case the taxpayer is not able to provide reliable evidence in this regard. We provide below our comments on the key items highlighted in the discussion draft.

I. The use of the CUP method

The current wording proposed emphasises the use of the comparable uncontrolled price method. There is no doubt that the comparable uncontrolled price method is a useful approach when it comes to evaluating the arm's length nature of commodity transactions. However, the reliance of this method, as also pointed out in the discussion draft, is very much dependent on the extent to which accurate adjustment can be performed given the facts and circumstances of the case. In this context, it may be useful to better link the concepts introduced in Chapter VI to this discussion draft. Namely, there are instances where the intra-group transaction would need to reflect the intangible contributions of other parties.

More generally, one would need to acknowledge that other transfer pricing method may very well apply to transactions relating to commodities. The Discussion Draft is silent on those at this stage.

The determination of remuneration and consequently the appropriateness of the quoted market prices as comparable uncontrolled price approach will depend on the value contribution and risks assumed by a particular entity to the overall value creation process. Commodity pricing may be influenced by a number of factors including for example political, regulatory, climatic risk factors, etc. which are often difficult to adjust for. These can affect the comparability of quoted market prices. In addition and perhaps most importantly, in some commodities market, publicly available pricing data tend to refer to transactions between parties that are in essence short term or opportunistic. Whilst in an intra-group context, the transactions may be long term and cooperative. It may be that commodities futures prices could partly address such issues especially in periods of significant changes in spot prices that were unanticipated in futures contracts previously concluded. In these contexts, the use of the CUP method may provide some indications of market prices, but is likely to necessitate further adjustments to reflect the difference in the nature of the relationship in the intra-group context *vs.* what is observed on the market. We note that the relationship is not an OECD comparability factor. Arguably, one could include it in the "economic circumstances" comparability factor. We believe that making this factor explicit would help in addressing the specificities of commodity transactions.

In all cases the appropriateness of the comparable uncontrolled price method versus alternative methods should be considered in context of a detailed value chain analysis, carefully considering the risk factors an entity is exposed to, and given the market they operate in.

II. Adjustments

The nature of the adjustments required and the validity of the approach should be based on a detailed analysis of the relations amongst related parties and circumstances under which a transaction occurs. Such analysis involves evaluating each party's value contribution to the overall value creation process, a careful consideration for risk assumed in markets in which the respective entities operate and an analysis of the potential difference in terms of the nature of the relationship as mentioned above. The current discussion draft alludes to the importance of this but more emphasis should be put on the importance of a detailed value chain analysis in the context of commodities. Such an analysis will provide the necessary tool set to aid the allocation of revenues (profits) to the respective entities and hence what adjustments may be needed. Please note however, that the value chain analysis should not aim at providing a substitution for the CUP method (or any other method), but rather to facilitate the application of the method. In this context, the use of industry standards can be useful information in the context of transfer pricing analysis but it may not substitute an in-depth analysis.

There are a large number of factors for a given commodity that can influence pricing. Examples include the commodity itself (e.g., quality in the case of crude oil), geography and the political landscape in which the respective entities operate (subsidies, regulation, tariffs etc.), size of the deal, business cycle and demand, and other factors such as the types contractual arrangements and related features, and economic conditions, to name a few. Thus, in most cases some sort of adjustment is unavoidable when considering dealings between entities of a particular group and relying on the comparable uncontrolled price approach. We do not believe that it is neither possible nor desirable for the OECD to attempt to list out let alone standardize the adjustments that are needed. Such adjustments should be case specific and reflect the contribution to value creation of the parties, the transaction at stake and the industry. In other words, there should not specific comparability criteria relating to commodity transactions.

The arm's length standard should be applied equally across industries and transactions. Introducing industry or transactions specific guidance would introduce uncertainty, complexity and likely provides opportunities for BEPS.

III. Timing of the Transaction

From an economic perspective, actual shipment or trading dates can be relied upon as indication of when a transaction has occurred. Since market prices can vary daily, using market data over a period prior the shipment or trading provide an indication of a range of market prices also taking into account daily volatility of the underlying commodity price may be relevant, although even this would depend on the facts of the case. The frequency of data available for a particular commodity can assist in determining the approach that can be relied upon on establishing the appropriate time period over which to analyse market data. In this context, the analysis should reflect the nature of the relationship between the parties. It may not be suitable to systematically rely without adjustment on short term spot transaction in the context of an inherently long term relationship. The timing of the transaction and the prices used as comparable should reflect potential differences in relationships.

In any event the dates to be evaluated and the approach to be followed should be based on the type commodity, the type contract, and the conditions in which the trade occurred.

Concluding Remarks

The discussion draft provides revised contents on the use of the comparable uncontrolled method and request feedback on typical adjustments to be relied upon and pricing date of the transaction in the context of commodity pricing. In our opinion,

- The analysis of commodity transactions should not be restricted to a discussion of the CUP method.
- The application of the arm's length principle for commodities transaction should not be different from the application of the arm's length principle for any transaction or industry and in particular there should be no commodities-specific adjustments prescribed for in the Guidelines