
Steering Committee
OECD Global Forum on Transfer Pricing
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10 September 2013

Comments on the Draft Handbook on Transfer Pricing Risk Assessment

Dear members of the Steering Committee,

Duff & Phelps welcomes the opportunity to provide comments in response to the Draft Handbook on Transfer Pricing Risk Assessment released by your Committee on April 30, 2013 (hereinafter referred to as "Draft Handbook").¹

We have read the Draft Handbook with great interest and share the Committee's observation that a thorough transfer pricing audit has a significant impact (in terms of time and costs) on both taxpayers and tax administrations. We also agree that strategic case selection through an effective risk identification and assessment process that is transparent to taxpayers would be critical to reducing "needless debates" among tax authorities, and efficient use of both taxpayer and tax authority resources.

In our view the Draft Handbook is -already in its current form- a valuable contribution to interpreting and understanding the transfer pricing risk process. We submit to your Committee comments and recommendations meant to contribute to the further enhancements of the Draft Handbook and an efficient and transparent transfer pricing risk assessment process with predictable outcomes for MNEs.

Preamble

The preamble of the Draft Handbook indicates that the "... handbook supplements useful materials already available with respect to transfer pricing assessment". We believe gathering this information and bringing it together in one document is a helpful exercise. However, in our view, further uniformity of the process undertaken by OECD members in transfer pricing risk assessments should be the ultimate goal. Although we acknowledge that the level of sophistication of tax administrations differs, we would welcome efforts from the OECD members for a common approach to transfer pricing risk assessment. We believe that when used in a similar manner by tax administrations this could significantly

¹ The opinions expressed in this letter are those of the authors and do not necessarily reflect the views of Duff & Phelps or its clients.

lower the administrative burden for the MNEs, and would contribute to transparency. Such a common approach should be also align with the work undertaken by other important organizations in this field, e.g., the UN.

1. Introduction to transfer pricing risk assessment

Inherent to the nature of transfer pricing risk assessment, “the tax administration will always be in the position of needing to assess the risk without a complete understanding of the potentially relevant facts”. Transfer pricing risk assessment is indeed a complex matter whereby often a large number of intercompany transactions between multiple countries need to be analyzed.

In our view, tax administrations would therefore require staff that is able to recognize the typical transfer pricing structures and identify the related risks. In addition, the staff should have the competence to make judgment calls, even if based on a certain level of uncertainty. They should be able to estimate the potential resource commitment in case of an audit and weigh that cost against the potential revenue to be raised from the audit. In addition, they also need to be able to identify specific questions to be considered during an audit. We understand that access to such a level of transfer pricing knowledge for some tax administrations may be difficult to achieve in the short term and believe that the uniform approach to risk assessment that we support would help to account for some difference in transfer pricing experience across countries.

We would answer your question “... whether transfer pricing risk assessment requires dedicated personnel with substantial transfer pricing experience, or whether risks can be assessed by audit staff with general responsibility for conducting a corporate tax audit” with a definite recommendation for dedicated staff with transfer pricing experience. Further, the OECD should encourage the development of training materials and courses that are focused on transfer pricing risk assessment. In addition, we would recommend establishing a monitoring protocol to evaluate the uniformity of the actual execution of the transfer pricing risk assessment process by the various tax administrations.

We also agree that it would be “... beneficial for tax administrations to follow regular and structured risk assessment steps”. A useful transfer pricing risk assessment should - at the very least - provide transparency regarding transactions that would be examined under such assessments, how much work and management time would be involved, the expected timeframe, et cetera for both parties. Other benefits of a common risk assessment approach might include consistency across multiple jurisdictions in terms of safe harbors, aggregation of transactions, and materiality thresholds.

2. Questions to be answered in a transfer pricing risk assessment process

One of the questions that could be addressed through a uniform transfer pricing risk assessment approach would be appropriate materiality thresholds. Very often MNEs, as well as transfer pricing practitioners, struggle with the definition of materiality. Questions that arise are:

- Should materiality be driven by auditors?
- Should materiality be evaluated after aggregation and possible set-offs (or netting) in various transactions and between similar tax payers?
- Are set-offs or aggregations allowed across all OECD countries?

The Draft Handbook mentions materiality both to the country conducting the risk assessment and to the taxpayer (size, etc.), however, we would suggest exploring this further and providing standards regarding materiality amounts (in Euros) across OECD countries to provide certainty.

The Draft Handbook remains largely silent on the issue of aggregation of transactions or possible set-offs, and the treatment of such set-offs within the context of risk assessment. We would welcome further uniformity in allowing taxpayers to be able to aggregate transactions and set-offs in measuring materiality. We believe this further consistency on materiality, set-offs and aggregation would provide additional emphasis for tax administrations to focus on relevant issues, while avoiding inefficient use of resources assessing the risk of potentially immaterial transactions.

3. Assessing when transfer pricing risk exists and when it does not

In section 3 of the Draft Handbook common practices are described to evaluate transfer pricing risk factors. It is stated that a number of "...items observed from the related party transactions may indicate higher transfer pricing risk". For example, Paragraphs 27 and 87 imply the acquisition of a business in a tax-efficient manner or use of effective tax planning by an MNE creates transfer pricing risk. In order to manage their businesses effectively, companies must consider various tax expenses and develop efficient structures where appropriate. These activities can be performed in a manner consistent with the arm's length principle through active management of the transfer pricing function and examinations of transfer pricing practices both pre- and post-acquisition. While we acknowledge these types of transactions may create transfer pricing risks, we believe that the Draft Handbook should clarify the fact that an observation of one or more of the listed items would not automatically lead to the conclusion that the transfer prices are not consistent with the arm's length standard. In our view, the starting assumption should be that most MNEs engage in legitimate transactions and seek to follow the arm's length principle.

One of the main concerns of MNEs is (financial) uncertainty. In general, it disrupts business operations. The Draft Handbook contains many potential situations that would give rise to a transfer pricing audit and hardly any guidance for an MNE to avoid transfer pricing inquiries. We feel there is a risk that the Draft Handbook could become an endless checklist for tax administrations to find a reason to start a transfer pricing audit. Therefore, we are of the opinion that the OECD should provide further clarification on when an MNE could be reasonably certain that it would not be subject to a transfer pricing audit (e.g., agreed upon safe harbors, transactional threshold guidance) and prescribe some uniformity to these measures.

4. Sources of information for conducting a transfer pricing risk assessment

The Draft Handbook lists a number of sources of information that can be examined by tax administrations allowing them to conduct a transfer pricing risk assessment.

As is pointed out in the Draft Handbook, many tax administrations already use specific informational returns to obtain relevant transfer pricing information. These forms vary largely in breadth and depth of the information they demand and in how they are used. In order to decrease the administrative burden on taxpayers of these existing and divergent informational returns, the OECD should recommend informational returns that are uniform and request a set of information that is relatively easy to gather and that provides a summary of the relevant transactions. Likewise, taxpayers should have some assurance that the information will be treated in a standard way (e.g., kept confidential) and that the information return does not lead to larger inquiries and additional onerous questionnaires prior to the decision on whether or not to audit the MNE.

5. Risk assessment process – selecting cases for transfer pricing audit

We believe that a successful transfer pricing risk assessment conducted in a transparent, regular, and systematic manner would enhance the case selection process for transfer pricing audits and lead to more certainty for both MNEs and tax administrations. It should contain items like scope, expected activities, critical decision points, a clear timeline, and - in the event of an audit - an audit plan. In our opinion, such an approach would be crucial to effectively use the tax administration's and the MNE's resources, to avoid careless inquiries, and to safeguard an outcome that provides certainty to the taxpayer that it is not subject to audit risk.

Currently, countries have set up transfer pricing risk assessment processes in different ways. In our view it would be beneficial if -to the extent possible- countries begin with an agreed baseline approach from which individual countries can build upon. As indicated before, we believe that this would significantly lower the administrative burden for the MNEs, which is a primary concern with respect to the transfer pricing risk assessment process. In our opinion the purpose of this guidance is to ultimately help reduce the taxpayers' burden and provide transparency to both the taxpayer and the tax administration, but concerns of additional costs and burden exist if a consistent process is not implemented uniformly.

In addition, we are in favor of open and transparent communication between tax administrations and taxpayers during the transfer pricing risk assessment process. Open communication throughout the process would allow taxpayers to explain their positions and answer any specific questions directly, so as to efficiently utilize the resources of the MNE and tax administration. In our view, communications with the tax administration should be included in the typical process as described in par. 136, effectively reducing the potential number of issues identified in an initial risk assessment phase.

6. Conclusion

We believe that the efforts of the Draft Handbook can lead to a more uniform and efficient transfer pricing audit selection process if implemented correctly. With a focused and experienced staff, a transfer pricing risk assessment can be used to increase transparency, provide certainty to taxpayers, effectively utilize MNE and tax administrations resources, while also avoiding inefficient transfer pricing audits focusing on non-material issues. The above should, however, be considered in the context that many tax administrations may still struggle with obtaining qualified and sufficient resources, which can lead to implementation issues in adopting an approach that is focused on transparency and uniformity.

Yours sincerely,



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