

September 9, 2013

By email

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Steering Committee of the OECD Global Forum on Transfer Pricing
Organization for Economic Co-operation and Development (OECD)

Subject: Comments on the Public consultation: Draft handbook on transfer pricing risk assessment.

IFA Mexican Branch (IFA Grupo Mexicano, A.C. and hereinafter referred to as IFA MX) is pleased to comment on the discussion draft of the above mentioned subject. Following are our comments which were divided by topic as analyzed in the referred document.

Section 1. Introduction to Transfer Pricing Risk Assessment

Paragraph 17 suggests that “*the more sophisticated the risk assessment system, the more insight it will provide in assessing the risk and the less likely it will be that audits will be unproductive and waste the tax administration’s limited resources.*”

It might be convenient to define or elaborate on the term *sophisticated* when referring to a risk assessment system as it might be undesirable for it to be understood as the more *burdensome* (for the taxpayer) the system, the more insight will it provide in assessing risk; moreover, when relevant work has been done to encourage application of transfer pricing simplification measures such as less stringent documentation requirements.

Section 2. Questions to be answered in a Transfer Pricing Risk Assessment Process

Paragraph 21 suggests that “... *Any company which has either a major shareholder, parent company or subsidiaries is quite likely to be a party to transactions between related parties. However, if a company is owned by shareholders, none of which has a controlling interest, and does not have any subsidiaries, then all transactions undertaken by the company will likely be with independent persons, and there is unlikely to be any material transfer pricing risk, except certain cases.*”

It is this IFA MX's opinion that Paragraph 21 might be interpreted as an aim to provide a definition for *related parties* when each jurisdiction has its own definition. Instead, it could be suggested having taxpayer's report controlled transactions with related parties under local definition.

Section 3. Assessing when a Transfer Pricing risk exists and when it does not
Paragraph 38 reads as follows:

"38. In some situations transfer pricing risk will be present because the taxpayer engages in recurring related party cross border transactions that have the potential of eroding the local country tax base. Such transactions can take many forms. They can simply consist of large volume sales or purchases of products or services. For example, if a local taxpayer in one of the extraction industries sells all of its local country output to related entities, small pricing discrepancies in each individual sale can add up to large reductions in the local tax base. Accordingly, recurring related party transactions will be one key risk factor."

IFA MX considers that Paragraph 38 could be misleading as the reduction to the local tax base in the suggested example would come from discrepancies in sales which could be identified with local compliance requirements (i.e. TP report, disclosure of controlled transactions) rather than from just having *recurring* controlled transactions. It might be confusing suggesting that *recurring* related party transactions will be one key risk factor; moreover considering Paragraph 40 which is apparently contradicting: *"However, recurring transactions alone will not necessarily indicate high risk..."*

Thus, IFA MX suggests removing last sentence from Paragraph 38 and moving Paragraph 40 above Paragraph 39 as follows:

38. In some situations transfer pricing risk will be present because the taxpayer engages in recurring related party cross border transactions that have the potential of eroding the local country tax base. Such transactions can take many forms. They can simply consist of large volume sales or purchases of products or services. For example, if a local taxpayer in one of the extraction industries sells all of its local country output to related entities, small pricing in each individual sale can add up to large reductions in the local tax base.
39. However, recurring transactions alone will not necessarily indicate high risk. Other

factors must be evaluated as well. In particular, consideration must be given to the nature of the transactions and the identity of the related parties participating in the transactions.

For example, large total volume sales of commodity products may not raise concerns if they are priced in accordance with publicly available market data and if the sales are to related parties in high tax jurisdictions. 40. It may be acceptable for the tax administration to disregard cases where the amount of tax at risk appears to be insignificant. In this context, it will be rational to have some quantitative transactional thresholds below or above which transfer pricing risk is deemed low, and cases are put aside from the candidates for audit. Common thresholds for this purpose would be based on the annual gross value of controlled transactions and/or income of the company.

Various references are done through the document to *large* payments as an indication of the existence of transfer pricing risk (P. 28, P. 41). Likewise document refers to *ongoing* payments to related parties as an indication of risk. Specifically, Paragraph 41 establishes that “*Payments of large total amounts of interest or insurance premiums to related parties, large total service and management fees paid to related parties and ongoing royalty payments to related parties for the use of technology, know-how, trademarks and brands or similar intangibles are all transactions that may warrant closer review.*”

Royalty payments for trademarks and brands could usually be *recurring* transactions between entities of an MNE. Having *recurring, large* or *small* (where local entity is the recipient of payments) royalty payments would not necessarily *warrant* a closer review and this mere suggestion might lead to confusion on whether authorities should take into consideration if payments were *ongoing, large* or *small* rather than proven to comply with arm’s length principle. It is our opinion that indication of risk should exist when transfer pricing documentation does not exist or suggests lack of compliance with at arm’s length principle and / or as Paragraph 45 establishes taxpayer’s compliance effort is proven to be insufficient.

Section 3.2 (Evaluating transfer pricing risk) suggests reviewing what could be considerable amount of information in a risk assessment stage. Paragraph 53 for example, suggests reviewing the financial results of the company to see if they deviate from potential comparable companies, Paragraph 57 and 58 suggest looking at the results of

the company in comparison to those of the related party which is on the other side of the identified controlled transactions and looking at the results of the company in the context of the whole of the group's performance. Likewise, Paragraphs 59 and 60 suggest a more detailed analysis consisting of comparing the activities carried on by the company with what the group does elsewhere.

It might be onerous to review suggested information solely to determine whether or not transfer pricing risks exist and to obtain information that might not be part of the taxpayer's transfer pricing documentation in the first place (i.e. the results of the related party). This would usually be done in an audit stage. It might be more effective to have the taxpayer reporting in whatever risk assessment tool available (as suggested in Section 4), key information obtained from its Transfer Pricing documentation (results obtained, margin, range, etc.).

Under Paragraph 70 "*Intra-group service transactions may be one of the most frequently occurring transfer pricing issues.*" IFA MX recommends reviewing the use of the term *issues* as it might be understood as if intra-group services represent *problems per se*. Wording could probably be modified to suggest that intercompany transaction *could* bring some transfer pricing concerns.

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

IFA MX recommends addressing this topic prior to the one in Section 3; this is, having Section 4 moved before Section 3 as it might be more efficient to look first at the available sources of valuable information and afterwards to the key points therein that indicate a risk.

Some of the suggested sources of information included in Section 4 (i.e. 4.6 "*Site visits and meetings with company personnel*") might be, for various reasons such as lack of resources or authority to do so, only achievable at an audit stage. Also, reviewing all this information in a risk assessment stage could be burdensome to both the authorities and the taxpayers and at some point the document might look more like a manual on how to conduct an audit rather than a transfer pricing risk assessment handbook. In our opinion, it could be practical suggesting members to assure having proper risk assessment tools

such as questionnaires, informative returns, proper transfer pricing documentation, etc; to identify potential risks and afterwards in an audit stage reviewing all suggested information (Customs data, Securities analysts' reports, press reports, etc.) based on preliminary findings.

In general terms, we would suggest elaborating more on the information that a risk assessment tool should provide (i.e. in the form of questionnaires, informative returns and the like) to promote having risk assessment stages more efficient in terms of costs and resources for both Tax Administrations and taxpayers.

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Should you have any question or comment in connection with the foregoing, please do not hesitate to contact us.

Sincerely,

IFA Grupo Mexicano, A.C.
Transfer Pricing Committee