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June , 2013

Steering Committee of the OECD Global Forum on Transfer Pricing  
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Steering Committee of the OECD Global Forum on Transfer Pricing

I am pleased to provide the following comments in response to the OECD Global Forum on Transfer Pricing public invitation to comment on the new Draft Handbook on Transfer Pricing Risk Assessment, released on April 2013.

#### **Preliminary Comment**

The objective of the Draft Handbook on Transfer Pricing Risk Assessment is to be a practical resource that countries can follow in developing their own risk assessment approaches; the handbook also supplements useful materials already available with respect to transfer pricing assessment.

I would like to start, by underlying the definition of Risk assessment. Risk assessment is defined as a systematic process for identifying and evaluating events that could affect the achievement of objectives, positively or negatively<sup>1</sup>. Any risk assessment is made on available information. Organizations identify and evaluate events information; therefore the starting point for a handbook on risk assessment should follow two questions:

- a) What information is available, and at what point of the assessment process?
- b) How can the organization structure a systematic process according to that available information?

The following comments were structured following premise:

*There are different stages in which a tax authority can perform a TP Risk Assessment.  
These stages are differentiated or characterized by the information that is available to the tax authority at that point in time, and by the amount of enforcement the tax authority has, in order to obtain more information from the taxpayer.*

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<sup>1</sup> Committee of Sponsoring Organizations, *Enterprise Risk Management,-Integrated Framework* (2004),p.16  
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Taking into consideration the aforesaid, following Figure 1, is a proposal of a scheme process, based on the two situations in which a tax administration can perform a TP risk Assessment: the “outside audit context” and the “within a general audit context”.

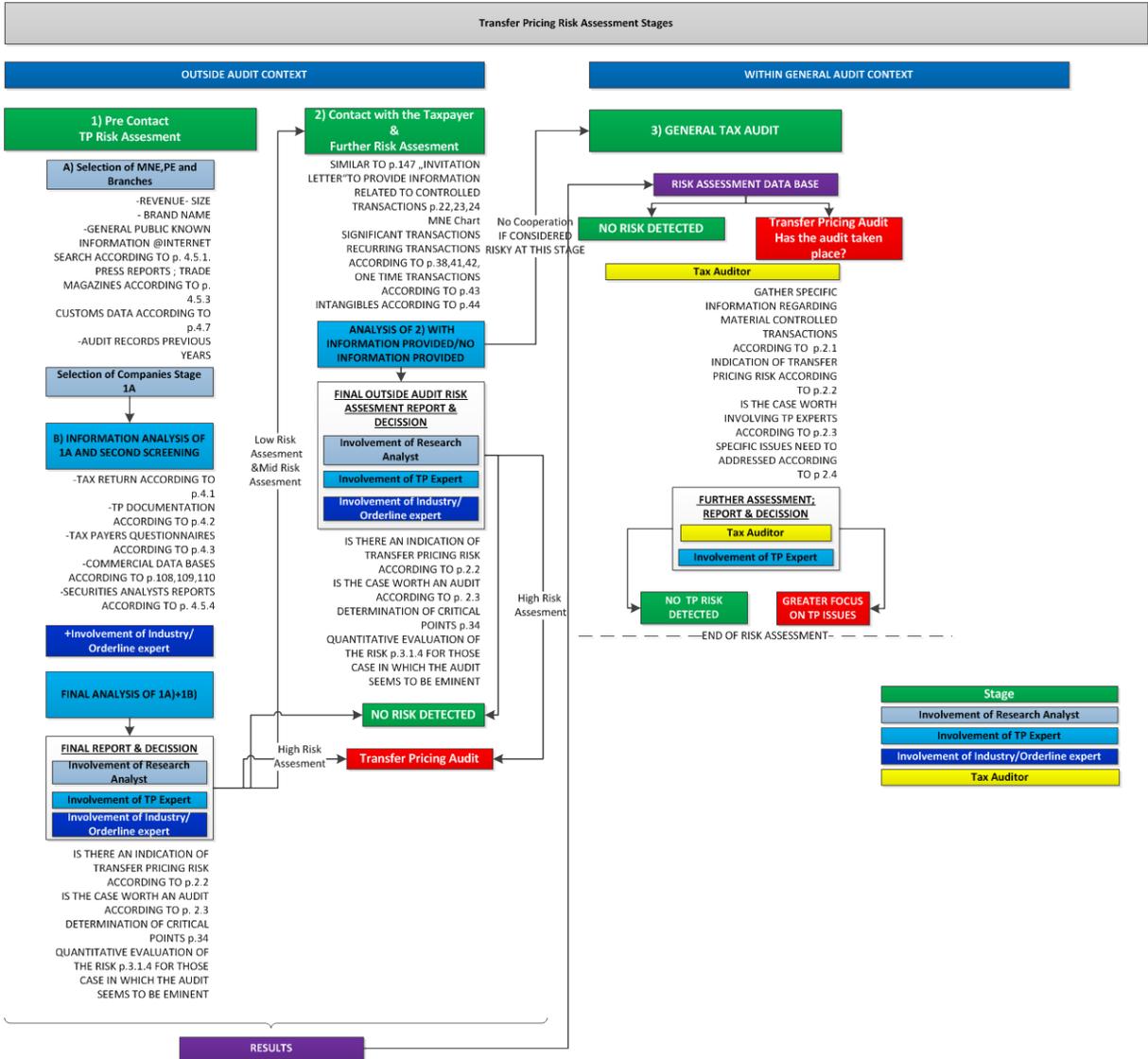


Figure 1

**Comments:**

All phases of the proposed process are based on the three main questions the TP Risk Assessment Handbook mentions in pages 8,9 and 10 p.2.1 to 2.4. At the end of each stage, the involved tax authorities should have a possible answer to these questions:

- a) Are there material controlled transactions?
- b) Is there an indication of transfer pricing risk?
- c) Is the case worth an audit?
- d) What specific issues need to be addressed during the audit if applicable?

## I. Outside Audit Context

Valuable information might be available within a no-audit context to perform a TP Risk Assessment. Figure one presents a proposal for this stage which is called “1) Pre Contact TP Risk Assessment” and it is structured as follows:

- i. at the beginning of the process a research analyst should be involved in order to prepare a report with information available publicly and within the tax administration service. (e.g. previous year’s tax returns).  
This analyst does not have to be a deep TP expert, since the first screening should comprehend preparatory documentation for the Transfer Pricing Expert to review.

Relevant paragraphs: 4.5 and 4.7, publicly available information regarding the taxpayer and Customs information.

*Specific Comment to p. 106:*

According to the Handbook, p.106 information within the taxpayer website, press releases, job vacancies etc. can be used to confirm the accuracy of the functional analysis in the contemporaneous documentation and to check some of the facts described by the MNE to tax authorities.

- Because of the potential ambulatory interpretation of public available information, I strongly urge that it is not proposed nor encouraged that the tax authority might use the information mentioned in p. 4.5.1 to evaluate the functional analysis, as mentioned in the relevant paragraph. This type of information should be used exclusively to understand in a superficial way what industry, what size, what main activity is being developed by the taxpayer. But in no sense, should the functional analysis turn into a simplistic process that could be confirmed by using such public available information.

The Steering Committee has to consider that sometimes company home pages are posted designed and developed by third parties that are not related to the company, the information available in a home page or a job posting would not necessarily deeply represent the economic reality. The valuable information from the company homepage and vacancy postings is probably related to the location of the legal entities part of the group, the size of the group, main activities, industry etc. But in no sense should it be used to confirm a FAR analysis.

With the public available information, the previous year’s tax returns and the custom data the analyst should be able to prepare a list of companies that could represent a risk in terms of Transfer Pricing.

- ii. The report is reviewed by a Transfer Pricing Expert and he should be in charge of elaborating a second screening. This second screening should be performed by a TP specialist because it would represent using more detailed data from the taxpayer, in

case the experience of the TP expert is not used in this stage, there might be a lot of missed clues regarding possible risk/non risk companies.

Relevant paragraphs: 4.1,4.2, 4.3, 4.5.2 (subp.108 to 110) and 4.5.4

*Specific Comment to p. 94:*

According to the report pg.22 the OECD is currently exploring, in connection with its transfer pricing simplification project, the extent to which some uniformity could be established in the nature of the information called for in these information reporting rules and the required format for responses.

- The need of more global homogenous information is absolutely critical for the tax administration, in a Pre-Contact risk assessment stage, the auditor has really poor information available, and not even the Company chart is available in some cases. How would they be able to proof if the company has operations in low tax jurisdictions (p.27)and how relevant they are, without the basic information?, a lot of companies could be discharged of representing a TP risk if at least the basic Master File Documentation (or a questionnaire with similar information) would be available to the TP expert performing the second screening in such a way, that the tax administration could focused its resources in those companies that really represent a risk.

*Specific Comment to subp. 99*

- I agree with the acknowledgement in sub paragraph 99 that the tax administration should carefully consider its contemporaneous documentation requirements. The OECD CTPA should encourage tax administrations to implement homogeneous documentation requirements or implement global questionnaires. As part of globalization, tax administrations should also understand that the more homogeneous the requirements are, the easier it is for a taxpayer to comply and the easier it is for Tax Administration Services to assess the risk.

*Specific Comment to p. 4.5.2*

The proposed p. 4.5.2 introduces the possibility of tax administration to review commercial databases.

- Based on our experience, the use of commercial databases should be carefully addressed. The information available in commercial databases does not present segmented financial information. If the tax authority wants to make an accurate risk assessment they have to use and address the commercial databases carefully. In some audits, we have experienced how a distributor is being compared to a full-fledged manufacturer with distribution activities without considering the split of financial information. In a lot of cases the tax authority has failed to perform an accurate qualitative screening, and as a result not accurate comparables might be used for the risk assessment.  
Therefore, we would recommend to advice the tax administration to train the TP auditors on the use of commercial databases and screening processes.

At the end of this stage, if considered necessary by the TP expert, an industry expert should be involved to review the securities analysts' reports (subp.113) together with the information already reviewed by the TP expert.

At the end of this stage, the team in charge of doing the risk assessment could come to a conclusion and determine which tax payers are having significant material controlled transactions, if there is a significant TP risk and in case of an audit what topics should the audit be focused on.

The assessment would be limited depending on the internal information disclosure rules in each country. Nevertheless, as mentioned at the beginning of the commentary, it is important to have a structure in place with the different steps to follow depending on the available information.

## II. Contact with the Taxpayer & Further Risk Assessment

This stage is a suggestion related to part 6 of the Handbook with a different perspective. For those tax administrations and in those cases in which information from the taxpayer is very hard to find, the tax administrations could explore the possibility of inviting the tax payer outside a tax audit context to freely provide information. The so called "invitation letter" is already in place in some countries for certain information. Tax Administrations with available information determine and select taxpayers that according to the analyzed information represent or could represent a risk. The Tax Administration Service sends a letter to the taxpayer inviting him to freely provide more information in order to clarify specific doubts to the Tax Administration Service.

- i. Within this stage, and as a result from the first stage, the tax administration contacts through an invitation letter the taxpayer with specific questions. The taxpayers have the option of ignoring the letter or answering to it and provide the information requested. The point of this letter is to gather information that in stage 1 was not available and that left the risk assessment unfinished due to lack of information.

The type of information collected through this stage, should include not only that information that was not available in stage 1, but also more detailed information to perform a deeper analysis.

Relevant paragraphs: 2.1 (subp:22-24) p. 3.1.1 (subp: 38 to 42) p. 3.1.2 (subp:43,44)

*Specific comment to subp.22 to 24.-*

I recommend that parameters regarding what will be understood as "relevant transaction" are established according to the type of industry and kind of MNE. I also consider relevant that the tax administration analyzes the information from a general and global perspective. In relation to subp.24 a tax auditor would locally be more interested in those taxpayers that make large payments to related parties, or receive small payments from related parties, than in those that make only small payments or receive large payments. I would not recommend making an assessment on that kind of statements without considering:

- a) The general conditions of the country (e.g. tax rate, development of the industry);
- b) The general global conditions of the taxpayer;
- c) The type of transactions;

*Specific comment in relation to subp.39.-*

Given the many situation in which a MNE enters into intercompany transactions with related parties that represent an insignificant risk to the tax authority I would like to propose that the tax administrations establish a minimum for intercompany Transactions when the taxpayer is exempt of TP burdens and documentation.

*Specific comment in relation to subp.40.-*

It is mentioned in subp.40, as an example, that 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. I would like to emphasis that there could be situations in which some industries sell commodities, after a specific process which does not change the characterization of the product as a commodity, but that involves a process that adds value to the supply chain.

While analyzing the sales of commodities I would recommend the tax administration in this stage to ask for the process description in order to analyze if the commodities go through an additional modification or process for which the company should be remunerated. In such a situation not only the price of a commodity is to be analyzed but also any raw material process involved too. This way, the tax administration will know if they are reviewing purely a commodity transaction or if the transaction has also another process involved.

*Specific comment in relation to subp.41.-*

I recommend the Steering Committee to prepare a comprehensive section related to what should be understood under “hard to value items” and how to identify them at this stage. Since from the in-house TP practitioner perspective it is very hard to imagine a non in house person performing evaluations on this kind of information in a non-audit context with limited information.

*Specific comment in relation to subp. 43 and 44.-*

I would like to comment that the scenarios in subp. 43 and 44 are delicate situations in which general information can be gathered at this point in order for the TP expert from the Tax Authority to evaluate if these situations could represent a risk. Nevertheless the Steering Committee should provide more guideline for the auditors to understand and evaluate how far a TP expert can go with the available information, this may vary for a in audit scenario where the tax payer will be able to deeply scrutinize the transactions with facts and information provided by the taxpayer directly.

### III. Within a General Audit Context

The Tax Authority is also able to make a TP risk assessment at this stage. This is probably the most important and significant stage, since the auditors are allowed to ask for information and the tax payer is obligated to provide it. General audits are performed with ordinary resources form the tax authority, at this point the Tax Administration Service should consider taking advantage of information collected at stages I and II in order to focus its efforts in defining if it is worth to involve the TP expert team in the audit to perform a scrutiny for the MNE intercompany transactions or if TP issues are not even relevant. Vertical coordination is needed at this point to further analyze the tax payer or to leave TP issues aside.

In this order of ideas, I recommend that the Tax Administrations manage a data base available to general tax auditors to consult if the MNE they are auditing has been analyzed by the TP experts and what the results were. More coordination between the risk assessment team and actual general auditors is crucial to know what risk the MNE represents.

At the end, this is the last opportunity a Tax Administration Service has to answer the three questions around which the whole risk assessment is developed:

- a) Are there material controlled transactions?
- b) Is there an indication of transfer pricing risk?
- c) Is the case worth an audit?
- d) What specific issues need to be addressed during the audit if applicable?

## **Conclusions**

- The process and steps to follow by the tax administration while performing a risk assessment always depend on the information available;
- The information could be systematized and processes could be simplified on a group level (see Comment on Documentation);
- Tax administration auditors are not always trained to develop an accurate risk assessment, it would help them to have a more structure process flow to follow;
- Together with the documentation project guidelines and protocols around the available information should be developed;
- There is a need of horizontal and vertical structure within the tax administrations in order to streamline the information, the analysis and conclusions from each risk assessment analysis.