Milan, 30 September 2013

Sirs,

Re: White Paper on Transfer Pricing Documentation – Public Consultation

We refer to the white paper published on 30 July 2013, on which public comments are expected by 1 October 2013.

1. We welcome with particular interest the preliminary results of the OECD debate on transfer pricing documentation requirements presented in the White Paper on Transfer Pricing Documentation (“the White Paper”). The need of both public administrations and taxpayers to receive common guidance on how, and for which reasons it is important to create a set of detailed documentation firstly encounters a great limitation that has to be overcome – i.e. the significant differences among countries’ domestic regulations. For this reason, we would like to respectfully offer Maisto e Associati’s contribution to the debate by commenting on certain particular aspects we consider of utmost importance.

2. The need of tax authorities to have access to sound, precise and easy-to-interpret information regarding specific MNE intercompany transactions and the necessity for taxpayers of achieving a high level of certainty and a balanced burden with respect to the organization and compliance with transfer pricing documentation requirements can in our experience only be achieved through a substantial standardization of the documentation requirements, formats and content in the OECD countries’ environment (and even outside the OECD).

3. Even if the White Paper detects these standardization needs, the reality depicted in the document is that the requirements may differ significantly from one country to another, thus creating evident issues for MNEs willing to effectively comply with transfer pricing documentation requirements and for tax authorities to achieve a satisfactory level of information. We welcome the White Paper’s efforts to provide more precise indications on how transfer pricing documentation should be structured by elaborating a “coordinated approach” (see Chapter V, Table 1), but we think that in order to be more effective, the White Paper should take more into consideration the best practice already developed and expressed, especially in the Code of Conduct on transfer pricing documentation for associated enterprises in the European Union (“EU TPD”), by soliciting its
direct use in order to create a standard documentation model that is able to satisfy the information needs of the vast majority of OECD member’s tax authorities. The EU TPD in fact already requires a full and comprehensive description of the MNE’s operative and organizational structure, markets, intercompany transactions, allocations of intangibles and assets, functional and risk analysis and description of the transfer pricing methods used, etc. Notwithstanding this general framework laid down by the EU TPD, implementation has revealed a significant number of differences. We believe that a new format at OECD level – which differs from the EU TPD standard – would introduce a further factor of confusion instead of an incentive to standardize the documentation set. A key move in this effort to standardize the comprehensive EU TPD may be well received if the push toward standardization is supported at the OECD level.

4. To achieve standardization at a national level, a stiff approach will be necessary. The Italian domestic experience may be considered as an example, where the implementation of the EU TPD format has been achieved through the introduction of regulations setting out very precise indications and imposing a rigid index covering all different arguments to be treated in the transfer pricing documentation set.

5. Even if we share in principle the observations stated at paragraph 28 regarding the 2009 survey of the European Commission, which notes that many taxpayers did not fully implement the EU TPD, we tend to consider that the latter, if adopted and implemented consistently by the majority of the countries, might lead to a correct balance between the tax administration’s rights to obtain information necessary to assess the arm’s length nature of taxpayer’s transactions and the compliance costs and burden to be borne by MNEs.

6. Standardization should not only relate to the documentation format (which is only one aspect of the matter) but also to the form of legal incentive available for MNEs who are willing to comply. The aim to create a “culture of compliance” is totally shareable and MNEs should work in this direction without any reservation notwithstanding the granting of favourable regimes from tax administrations. On the other side, tax authorities should endeavour to encourage MNEs to comply with transfer pricing documentation requirements by elaborating effective and non-distortional incentives; the White Paper mentions, inter alia, the non-application of penalties in case of a transfer pricing adjustment if the MNE complies with its documentation duties. This model of incentive seems to be particularly effective in those countries where penalties can be very high (this is the case of Italy where, for example, penalties can range from 100% to 200% of the adjusted value).

7. Having a direct experience in Italy with the kind of penalty protection regimes triggering the non-application of penalties when proper documentation has been drafted, the feeling is very positive and taxpayers are willing to bear the additional and not insubstantial costs of preparing the transfer pricing documentation (“TPD”) – but only if, in return, they may count on the elimination of penalties in case of adjustment.

8. The conclusion reached at paragraph 55 regarding the “negative” side of a compliance incentive based on the reduction/elimination of penalties is not entirely shared. From a pragmatic point of view, the creation of a culture of compliance may well be achieved through a reduction of penalties in case of
compliance. This approach seems to create a perfect synthesis between the need of tax authorities for information (difficult to discover even in case of in-depth tax audits) and the necessity of forecasting the tax risk for MNEs. As mentioned earlier, for instance, the Italian regulations provide that in case the MNEs under scrutiny provide a full set of transfer pricing documentation and comply as well with particular filing requirements (namely ticking an appropriate box in the annual tax return), no penalties will be applied in case of an adjustment. This mechanism seems to trigger a positive response from MNEs. Such incentive is quite reasonable (considering the high penalties mentioned above) and the existence of such a penalty protection regime is a proper justification for the conduct, which fits – in our view – with the introduction of a “culture of compliance”.

9. One delicate point that should be addressed at the OECD level is the clear delimitation of the tax authorities’ power to refuse the acknowledgment of the validity of the TPD set prepared by the taxpayer and thereby deny the penalty protection. As you may appreciate, this is a crucial aspect of the incentive mechanism. A sound and reasonable approach would be that a TPD set can be refused (and then trigger the application of penalties) only when it lacks important information (such as the description of core and valuable intercompany transactions) or contains plainly false information (which is different from the case that purely material mistakes are found therein) or there is a disagreement between the taxpayer and the tax authorities regarding the transfer pricing methodology to be used in order to ascertain the arm’s length level of the transaction. A step forwards in this direction will, in our opinion, be a genuine and real move towards certainty.

10. The discussions with business representatives (BIAC) (paragraphs 39-40) clearly underlined the difficulties MNEs encounter in complying with differing, diverse and invasive requirements; in particular, we comment on a certain focal issues in the following paragraphs.

11. An aspect that requires particular attention is the use of local instead of regional comparable samples. On this matter, a common international consensus should be achieved, most importantly in order to grant certainty to businesses. It is not uncommon that the tax authorities of certain countries do not accept comparables other than local ones. To a certain extent, this creates additional costs to taxpayers, who have to perform a local economic study and cannot rely on regional studies (which are those commonly used to set the transfer pricing at the group level). Moreover, the preference for local comparables is, in the majority of the cases, not corroborated by any evidence of a higher reliability, which could be the only reason to prefer one set of comparables with respect to another. Without clear guidance on this aspect, the chances of observing an increase in the costs for MNEs triggered by the need of preparing purely local economic studies in order to comply with local tax authorities’ requirements will increase. Having said that, it is also desirable that in those cases where a specific tax authority requires a purely local study to ascertain the arm’s length value of a specific transaction and the taxpayer instead genuinely relies on a sound regional study, the non-application of penalties has, in any case, to be assured.

12. A requirement of an annual update of the economic analysis would also contribute to an increase of costs for maintaining the transfer pricing documentation. It would therefore be welcomed if an official positive position on
a proposal of considering it sufficient to update the full search of comparables forming part of the economic analysis only every few years (for instance, three years would be reasonable to maintain effectiveness and reliability) and retain only the annual update for the comparables financial data. A similar measure is provided for by the Italian Regulation, which provides (only for companies with a turnover lower than EUR 50 million) for the renewal of the economic analysis every three years. This measure has been well received considering the evident reduction of costs and compliances for the benefiting companies.

13. A further aspect where standardization is highly relevant and which requires a common consensus among different tax administrations is represented by the materiality threshold of intercompany transactions. This is extremely important especially where one of the requirements of TPD is completeness of information on all transactions. It is correctly stated at paragraph 77 that, “Not all transactions are sufficiently material to require full documentation.” Current everyday practice suggests that in the complete silence of the local tax administrations, the decision of a MNE to include or not a certain transaction in the documentation is fully left to its discretion (and risk). Moreover, the lack of a definition in the domestic legislation of what can be considered as “material” with reference to the amount of an intercompany transaction may create uncertainty in the sense that the lack of description of certain intercompany transactions (unilaterally determined by the taxpayer as immaterial) can be considered an argument to substantiate the documentation unreliability and thus the loss of penalty protection on overall.

14. The above-mentioned risk is unacceptable and can only be reduced by introducing at the international level sound criteria to identify a materiality threshold. The White Paper suggests that “the size and nature of the local economy, the importance of the MNE in that economy, and the size and nature of local operating entities, as well as the overall size and nature of the MNE group” should be taken into account. We believe that such a complex and, again, subjective, criteria cannot be considered feasible and effective. The identification of a materiality threshold should instead be related to an objective evaluation process and amount, like, for example, the MNE consolidated turnover or the total amount of the same class of intercompany transactions.

15. An example of the above may be the following. In order to understand whether a certain intercompany transaction can be considered as immaterial, a possible approach could be to verify its weight with respect to the total amount of the intercompany transactions concluded by the company. For the sake of clarity, transactions lower than 1% of the total intercompany transactions can be considered as immaterial. In this way, the methodology is simple, certain and proportional (i.e. if intercompany transactions are equal to EUR 20 million, transactions below EUR 200,000 may be correctly neglected).

16. Furthermore, the materiality concept should also go beyond the purely quantitative element and be extended also to a “qualitative” analysis. It is clear that within the context of MNE operations, there are several intercompany transactions that are fairly standard and do not leave any room for particular tax-erosion risks. These are, for instance, low-value added services, cash pooling arrangements, etc. For such types of transactions, it could be provided that, despite the obligation to provide information on the existence and size of such transactions, taxpayers are not bound to provide full documentation on the
transfer pricing methodology utilized. Such analysis could also be connected with the EU Joint Transfer Pricing Forum work on low-value added services and with the on-going analysis of the Committee on Fiscal Affairs on safe harbours (i.e. the Revised Section E on Safe Harbours in Chapter IV of the Transfer Pricing Guidelines of 16 May 2013).

17. With reference to Chapter IV(C), we agree that a mandatory intervention/certification of outside auditors should not be encouraged and may reduce the attitude of a MNE to comply. The reason for this is the necessity to maintain the documentation process as an affordable and fairly simple obligation.

Yours sincerely,

Maisto e Associati