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30 September 2013

Centre for Tax Policy and Administration
Organisation for Economic Co-Operation
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Via email: TransferPricing@oecd.org

**RE: Tax Executives Institute Comments regarding the
OECD's White Paper on Transfer Pricing
Documentation**

To Whom It May Concern:

In November 2011, Working Party No. 6 of the OECD's Committee on Fiscal Affairs approved a programme of work on transfer pricing simplification, including a project on the simplification of transfer pricing documentation requirements. As part of this work, on 30 July 2013 the OECD published a *White Paper on Transfer Pricing Documentation* (White Paper) and requested comments from the business community and other stakeholders. On behalf of Tax Executives Institute, Inc. (TEI or the Institute), I am pleased to respond to the OECD's request for comments.

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organisation has 55 chapters in Europe, North America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 members represent over 3,000 of the largest companies in Europe, the United States, Canada, and Asia.

Comments on the White Paper

In General

TEI welcomes the publication of the White Paper as a good first step in the OECD's effort to standardise and simplify burdensome and

costly transfer pricing documentation requirements. Tax authorities and taxpayers have much to gain from standardisation, which would allow taxpayers to focus on providing qualitative information to tax authorities rather than on meeting often inconsistent formal requirements.

We are concerned, however, that the recommendations in the White Paper may lead to an unnecessary increase in transfer pricing documentation requirements. For example, many of the countries surveyed by the OECD¹ do not request much of the information listed in Table 1 to be included in the global “masterfile.”² In addition, adoption of the White Paper’s recommendations does not guarantee a corresponding reduction in local country documentation requirements. Moreover, the provision of “global” information to local countries may result in misunderstandings or misuse of the information, leading to unnecessary additional information requests and audits.

To allay these concerns, TEI recommends that the OECD adopt an overall, global transfer pricing documentation standard that could be adopted wholesale by individual countries (including developing nations). The OECD should craft such a standard to be generally sufficient for all transfer pricing documentation purposes. To the extent individual countries decide that the global standard is insufficient, the OECD could provide a framework through which those countries could obtain additional information.

TEI agrees that transparency in transfer pricing is necessary, but it should be expected of both taxpayers and tax authorities. Tax authorities should be encouraged to consult with taxpayers throughout the audit process, rather than back-loading the discussion at the end. Further, the White Paper should explicitly state that the use of data not available to taxpayers (*e.g.*, “secret” or “hidden” comparables) is impermissible. For the same reason, tax authorities should not use their privileged access to information that is unavailable to taxpayers regarding margins used in neighbouring jurisdictions to require taxpayers to apply the same margins in the authorities’ jurisdictions (*i.e.*, the so-called “race to the top”). Even if tax authorities are only permitted to use the margin information (or similar data) for risk assessment purposes, the chance that such information will be misused is high.

In many cases the White Paper recommends that tax authorities collect global information that is not easily available to taxpayers. Thus, we recommend in general that requests for information only be based on data that is available to a multi-national enterprise (MNE) or that could be readily available.

The White Paper also recommends that tax authorities collect competitively sensitive information. Examples of such information include important drivers of business profits, a written functional analysis showing the principal contributions to value creation by individual

¹ See White Paper, Annex 1.

² *Id.* at Table 1 (pages 23-24).

entities within the group, and a description of the MNE's strategy for the development, ownership and exploitation of intangibles.³ MNEs are highly sensitive to the disclosure of confidential information to competitors, particularly in countries without appropriate safeguards for taxpayer confidentiality. Because of the sensitivity of this and related information, the OECD should recommend that tax administrations maintain strict confidentiality over this data. Access should be limited to "need to know" personnel and appropriate statutory safeguards should be in place, including strong penalties for unauthorised disclosure.

Finally, we note that certain countries require that independent auditors certify a taxpayer's transfer pricing documentation. This requirement is burdensome and costly for MNEs, and in most cases the cost of obtaining a certification outweighs any tax administration benefits. Therefore, the OECD should recommend that countries abandon this practice; indeed, the White Paper notes that this requirement may be "excessive."⁴

*Overview of Existing Guidance on Transfer Pricing Documentation – Local Regimes and International Organisations*⁵

The White Paper identifies two main sources of transfer pricing documentation rules: local country documentation regimes and guidance provided by international organisations, such as Chapter V of the OECD Transfer Pricing Guidelines. The White Paper notes that the number of countries with local transfer pricing documentation rules continues to increase. Because of the varying requirements of these regimes, MNEs must often comply with several sets of documentation requirements, which is a costly endeavor. Regrettably, while the White Paper mentions this compliance burden in the introduction, the burden mostly goes unnoticed in the balance of the paper, which focuses almost solely on the needs of tax authorities. TEI submits that the burden imposed by transfer pricing documentation requirements should be one of the primary concerns of the White Paper and should be balanced against the needs of tax authorities.

The White Paper states that transfer pricing analysis is often single-sided and does not provide a complete understanding of an MNE's global business. It bears noting, however, that the tax authorities in some countries are not always willing to consider a "global picture" analysis (*e.g.*, when a one-sided approach is in their favor). On the other hand, requests for transfer pricing information should be limited to information relevant to the transaction(s) being analysed, which may or may not require an examination of the MNE's global business. Further, disclosure of information regarding all of an MNE's advance pricing agreements (APA) and rulings can only lead to additional transfer pricing controversy, especially when they have

³ See *id.* Many of the other items listed in Table 1 also constitute sensitive business information.

⁴ *Id.* at 21.

⁵ *Id.* at 5-11.

no relevance or direct link to local transactions. For example, tax authorities have an unfortunate tendency to focus on certain terms and conditions of these documents (such as prices and markup percentages) to argue for higher local results without recognising that the local market or the affiliate's specific situation may not be comparable to the facts in the APAs and rulings.

The White Paper discusses the European Union transfer pricing documentation (EUTPD) model, which consists of a master file and a local country file. Business generally welcomed this initiative, hoping it would ensure some degree of consistency across the EU. Unfortunately, the EUTPD is optional, and the divergence of local country documentation requirements effectively neutralised any of the benefits of standardisation. This is the case even though many differences are merely in data formats or presentation. Further, the White Paper acknowledges that the EUTPD-required disclosure of all APAs and rulings can be a stumbling block for taxpayers.⁶ Paragraph 28 raises additional problems with the EUTPD model, and TEI recommends that the OECD address these issues going forward as they are directly relevant to this OECD project.

Discussions with Selected Business Representatives⁷

TEI agrees with the point made by business representatives that any effort to standardise the format of transfer pricing documentation would be helpful. Countries have different views regarding regional versus local comparables and how frequently to update a comparable search. This results in a significant commitment of time and expense on behalf of an MNE and often produces little added value for tax authorities. TEI recommends that the OECD adopt the suggestions from business representatives regarding updates of comparable studies. Specifically, an annual update of financial data only for selected comparables should be considered sufficient, and a new transfer pricing study should only be required every 3-4 years.

TEI also urges the OECD to promote flexibility when it comes to comparables, such as permitting the use of regional or even worldwide comparables when local information is unavailable. This would address the fact that reliable information can only be found in a limited number of countries and almost never in emerging economies. Similarly, certain industries are unique, with comparables only available on a worldwide basis. In addition, a group of companies with foreign operations (*i.e.*, another MNE) should also be acceptable as comparable if there is strong comparability in terms of business model with the benchmarked organisation. As to the geographic scope of comparables generally, we submit that the tax authority should bear the burden of proof when challenging the scope selected by the taxpayer.

⁶ *Id.* at 9.

⁷ *Id.* at 11-12 (as part of the preparation of the White Paper, the OECD conducted a series of conversations with a few members of BIAC).

Finally, we recommend that local transfer pricing documentation requirements include defined materiality standards, taking into account company size. It is often the case that a materiality threshold that is reasonable from the local company's perspective is immaterial from the perspective of the entire MNE. As a result, businesses tend to set internal materiality thresholds to balance resources and efforts, taking into account the cost and time needed to comply and the potential cost of non-compliance.

Purpose of Transfer Pricing Documentation Requirements⁸

The White Paper identifies three primary reasons governments request transfer pricing documentation. The first is to provide necessary information for a transfer pricing risk assessment. In this regard we note that transparency should work both ways. Taxpayers should provide the necessary information to the tax authorities, but also should have a chance to discuss the risk assessment with tax authorities throughout the process and not after the tax authorities complete the assessment. The OECD should encourage tax authorities to adopt an open and cooperative approach.

The second reason is to ensure taxpayers give appropriate consideration to transfer pricing requirements. The OECD comments in the White Paper that tax authorities often view documentation as "canned" or formulaic and not representative of a considered analysis. We note that this view reflects the proliferating demand by tax authorities for transfer pricing documentation. In certain cases, the burden placed on a taxpayer can exceed the ability of an in-house tax department to provide the requested documentation, even if the department's efforts were solely devoted to transfer pricing. Simplification and standardisation of transfer pricing documentation may be the only way to improve this situation.

The third primary reason governments request transfer pricing documentation is to provide information necessary for an audit. The White Paper stresses that taxpayers should provide tax authorities with all the information needed to conduct a thorough transfer pricing audit. Nevertheless, we emphasise that tax authorities should consider the burden placed on the taxpayer by documentation requests.

Overall, a fruitful approach may be to moderate the initial documentation demands from local authorities for purposes of the first two reasons cited above, while preserving their right to ask for additional information on audit. This could prove beneficial for both sides.

⁸ *Id.* at 13-19.

*Tiered Approach to Transfer Pricing Documentation*⁹

The White Paper proposes a tiered approach to transfer pricing documentation. High level information would be used for transfer pricing risk assessment purposes and more detailed information would be requested in the course of a transfer pricing audit.

Paragraph 71 states that transfer pricing risk often arises in situations where taxpayers seek to purposely shift income from where it would be “relatively heavily taxed” to where it will be subjected to “lower levels of tax.” We recommend that the OECD provide guidance on when a tax rate differential is large enough to be considered a risk factor. Otherwise, the current wording can be read to suggest that related-party transactions between two jurisdictions where one has “lower levels of tax” may be considered an attempt to shift income by default, rather than being conducted for legitimate business reasons. At the same time, the OECD should not forget that tax competitiveness continues to be a tool governments (including Member States of the OECD) use to promote their economies and attract investments. Is the resulting lower effective tax rate also a risk factor in those cases?

Paragraph 72 states that a business whose distribution of employees, assets, and income are not roughly even across low and high-tax countries may warrant more “tax administration attention” than a business with a more even distribution. It is inherently incorrect, however, to expect income allocation to match employee and asset allocations. Take the example of a labour intensive industry. Assume that a principal company sets strategy, makes decisions, bears risks, *etc.*, and has 400 employees and its contract manufacturing entity in another jurisdiction has a plant and 4,000 employees, but does not bear any risk (even that of foreign exchange). Assume further that the manufacturing entity sells all of its output to the principal with a guaranteed positive margin. In this example, it is unreasonable to argue that allocation of income and employees/assets across those two entities should be even or roughly even. All of the risk is centralised in the principal company, and there is no reason to expect that the principal’s company’s income from its onward sale of the manufacturing company’s output should somehow be split between the two countries according to their relative amounts of employees and assets. We urge the OECD to clearly state that tax authorities should analyse the taxpayer’s business as a whole before applying rigid rules in the course of an audit.

As noted above, the two-tiered masterfile-local file approach is generally welcome, but only if it results in a decreased documentation burden. A complicating factor is that not all MNEs are organised centrally or integrated. In the case of regionally centralised MNEs, obtaining all the requested information on a global level will actually increase the compliance burden for the taxpayer, while not necessarily being relevant to tax authorities when analysing local or regional transactions. We suggest that tax authorities assess the overall organisation of a taxpayer before making a documentation request instead of routinely requesting the

⁹ *Id.* at 19-22.

masterfile. Another potential solution would be to allow taxpayers to keep the masterfile on a regional basis, which would be in line with the flexibility allowed in Paragraph 76 where taxpayers can keep a masterfile on a business line basis (TEI supports this flexibility).

We agree with the first bullet of paragraph 77 that a requirement that taxpayers have outside auditors certify transfer pricing documentation is excessive, especially at the risk assessment stage, as MNEs often have the required expertise in-house. We also agree with the last bullet of paragraph 77 recommending a definition of materiality that reflects the size and nature of both the local economy and the MNE. This definition should reduce transfer pricing documentation burdens.

*Development of a Coordinated Approach to Documentation*¹⁰

The White Paper proposes five categories of information to be provided in a masterfile while specific transfer pricing analysis would be included in a local file. With respect to the masterfile, we have several recommendations.¹¹ First, as noted above, the documentation requirements should take into account that not all MNEs are fully centralised or integrated; thus, the relevant information is often not readily available. Second, in our view, tax authorities should only request masterfile information for business units that have operations in their jurisdiction. As discussed above, the disclosure of global information may result in misunderstanding or misuse of the data.

Third, the OECD should clarify that tax authorities should only request the information listed below when the MNE or particular business unit has an integrated supply chain as the information is generally only readily available to businesses organised in that manner. Businesses without an integrated global supply chain would have to engage in a difficult and work-intensive process to collect and process the information. The information includes:

- (i) a chart showing supply chain for material products and services;
- (ii) a chart showing important related party service arrangements other than research and development services;
- (iii) a written functional analysis showing principal contributions to value creation by individual entities within the group; and
- (iv) a list of important related party agreements related to intangibles, including cost contribution arrangements, principal research service agreements, and important license agreements.

¹⁰ *Id.* at 22-26.

¹¹ Table 1 on pages 23-24 of the White Paper sets out the information to be included in the masterfile.

Fourth, the OECD should provide clear criteria counting the number of employees in a particular country. Does an MNE count full-time employees only? Permanent or temporary employees? Contractors and seconded employees? Should the time of measurement be at year-end or based on some kind of average? Clear guidance on this point would likely prevent a large amount of controversy. Fifth, the confidentiality of a taxpayer's information should be respected, and information requests should be limited to the transactions at issue. For example, if an MNE is not fully centralised, information about business restructurings in other regions may be not available on a regional level. Moreover, such information generally has no direct relevance for a transfer pricing risk assessment in another region.

Sixth, in our view, the "financial and tax position" information listed by the White Paper is much more extensive than many current documentation requirements. Requiring taxpayers to produce this information would only increase the documentation burden. Therefore, this information should be requested only on a case by case basis after careful analysis by tax authorities. Finally, the requirement to list all MAP proceedings would be detrimental to MNEs, absent a measure to prevent the abuse of that information by tax authorities (*e.g.*, authorities may use the MAP proceedings as a basis for requesting information or issuing assessments for the issues listed in those proceedings).

We also have several comments with respect to the information to be provided in the local file.¹² The proposed scope of the local documentation file is similar to existing documentation requirements. Because of this overlap, producing the information required in the local file in conjunction with that of the proposed masterfile would result in significantly increased compliance burdens for taxpayers, which is contrary to the aim of the White Paper. If the OECD proceeds with the two-tiered approach, it should specify what is relevant and why, taking into account the project's simplification goal for both tax authorities and taxpayers. For example, a description of the taxpayer's research and development function will likely be irrelevant for a country with only a sales agent.

As with the masterfile, the OECD should clarify that tax authorities should request the following information only if the MNE or business unit has an integrated supply chain:

- (i) a detailed functional analysis of the taxpayer with respect to each documented category of controlled transactions, *i.e.*, functions performed, assets used (including intangibles) and risks borne including any changes compared to prior years; and
- (ii) an indication of the most appropriate transfer pricing method with regard to the category of transactions at issue and the reasons for selecting that method.

¹² Table 2 on page 25 of the White Paper sets out the information to be included in the local file.

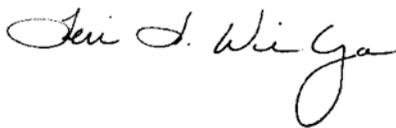
The OECD should also encourage countries to accept a common documentation template (perhaps one developed by the OECD), rather than insisting on specific requirements. In many cases, a country will ask for data that an MNE has already prepared, but in a different format or presentation style.

Finally, guidance for documenting branches would be greatly appreciated. The current guidance is often lacking and, where present, creates confusion among taxpayers. For example, it is often unclear whether documentation covering the entire MNE and its branch is acceptable, or if a separate file for the branch is required no matter the size or scope of its activity.

Conclusion

TEI appreciates the opportunity to comment on the OECD's White Paper on Transfer Pricing Documentation. If the OECD believes our participation in the announced public consultation in November 2013 is warranted, we would be pleased to do so.¹³ These comments were prepared under the aegis of TEI's European Direct Tax Committee, whose Chair is Alexander Kölbl, and the Transfer Pricing Subcommittee of TEI's European Direct Tax Committee, whose Chair is Alain Berlier. If you have any questions about the submission, please contact Mr. Berlier at +41 79 201 21 79, alainberlier@hotmail.com, or Benjamin R. Shreck of the Institute's legal staff, at +1 202 638 5601, bshreck@tei.org.

Sincerely yours,
TAX EXECUTIVES INSTITUTE, INC.



Terilea J. Wielenga
International President

¹³ TEI has participated in several previous OECD public consultations regarding transfer pricing, most recently in November 2012 with respect to the proposed revisions of the section on Safe Harbours in Chapter IV of the OECD Transfer Pricing Guidelines.