UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

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VIA EMAIL

Mr. Pascal Saint-Amans
Director, Center for Tax Policy and Administration (CTPA)
OECD, 2, rue Andre Pascal
75775 Oarus /Cedex 16
France
(*Pascal.SAINT-AMANS@oecd.org* / *TransferPricing@oecd.org*)

Re: USCIB Comments on the OECD's White Paper on Transfer Pricing Documentation

Dear Mr. Saint-Amans,

This letter is in response to the request for comments on the OECD's White Paper on Transfer Pricing Documentation (the "White Paper"). The United States Council for International Business[1] commends the OECD for tackling the difficult issue of transfer pricing documentation. As the White Paper notes, documentation requirements increase every year and impose a significant burden on business. Thus, it is important to carefully consider the documentation requirements and ensure that they are fit for purpose.

USCIB has undertaken a review of the White Paper but given the time frame for producing comments and the other substantial OECD documents and projects that require a response, this letter should be considered a preliminary response, which may be expanded at a later date. Also, in response to the compressed time schedule we have focused our comments on sections IV and V of the White Paper.

We do, however, have a few brief comments on sections II and III of the White Paper. Section II B of the White Paper omits any discussion of the UN approach to transfer pricing documentation set forth in the UN's Transfer Pricing Manual. We believe that approach ought to be considered and, in particular, the notion that detailed transfer pricing documentation ought to be provided only upon request deserves consideration.

On section III of the White Paper, USCIB agrees that documentation may serve different functions; that the three functions described (risk assessment, audit and encouraging taxpayer compliance) are legitimate; and that these three functions require different levels of documentation at different times.

[1] USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

USCIB does not believe that documentation has served these purposes in the past; rather the main function of documentation was encouraging taxpayer compliance through the imposition of penalties for inadequate documentation. USCIB believes requiring documentation targeted to risk assessment, as the initial information gathering effort, if done right, will go a long way to "avoid excessive documentation requirements while at the same time providing for adequate information to apply the arm's length principle reliably" – leading to valuable simplification. To the extent that more limited information is supplied initially, it is important to have reasonable time frames for taxpayers to comply with additional requests for information. It is also important to consider the transition from the current documentation regime to a fundamentally different approach.

Comments on Section IV

USCIB has both policy concerns and considerable technical issues with this section. The goal of revising transfer pricing documentation ought to be twofold: to provide more useful information and to reduce the burden of producing reams of paper on transfer pricing documentation. We are concerned that the new information that the OECD is seeking is not targeted enough to provide more useful information and that not enough attention has been paid to the goal of burden reduction.

Paragraph 69 quotes from a January 2012 OECD publication[2] on nine features that indicate risk. Given the extensive coverage of this issue by the Draft Handbook on Risk Assessment, we believe reference to these nine factors ought to be replaced with a reference to the relevant portions of the Handbook. One key element that is reflected in the Handbook but is not reflected in the White Paper is factors that indicate low risk. These factors should be incorporated into the White Paper and taxpayers whose behavior indicates low risk should have a reduced compliance burden.

Paragraph 72 of the white paper states "[i]t seems possible for businesses to provide without undue burden individual country data based on either management accounts, consolidating income statements and balance sheets, and/or tax returns that would provide tax administrators with a general sense as to how their global income is allocated and where pressure points in the transfer pricing arrangements might lie." As a preliminary matter, it is important to point out that for multinational enterprises distinctions related to country location are not particularly important. Rather business is organized along product lines, projects, functions, and regions, so information pertaining to activities within particular countries may have very little relevance apart from the need to determine tax liabilities. Thus, the suggestion that information can be provided without undue burden will depend very much on the level of detail that is required. If detailed information is required then the associated burden may be significant. If high-level information in the nature of total sales or gross receipts, fixed assets, cash taxes and headcount are required, then the burden associated with breaking out these numbers at the country level is probably manageable. We are aware that the OECD is interested in meeting with companies to discuss the types of information that can be made available and hope to facilitate this dialogue.

[2] Dealing Effectively with the Challenges of Transfer Pricing".

The white paper acknowledges that such information "would likely not be a sufficient basis for a detailed transfer pricing analysis of individual transactions and prices". Business agrees that country-by-country reporting is insufficient for a transfer pricing analysis. That is, country-by-country data is not transactional and therefore is not useful for a FAR analysis or to provide data for comparables. Business is concerned that country level numbers would not be used just for risk assessment, but to determine the adjustment. That is, tax administrations may use the country-by-country information to allocate income using a formula rather than the arm's length standard. Business is especially concerned about non-OECD member countries, particularly developing countries with significant capacity constraints, using this information inappropriately. Business believes that formulary apportionment is the wrong answer. Further, unless these numbers are based on uniform accounting principles, the numbers will not be meaningful. Although there have been efforts to make accounting principles more uniform in recent years important differences remain; high-level unaudited, unreconciled numbers that may provide useful information for risk assessment are totally inadequate for actually computing global income. If the OECD does move forward with recommending country-by-country reporting of some sort, it is necessary that any such recommendation explicitly reject the use of these numbers for the purpose of allocating income. At a minimum, the word "likely" ought to be deleted from the second sentence of paragraph 72 so it would read as follows: "Such information would not be a sufficient basis for a detailed transfer pricing analysis ….".

We understand that there is tremendous political pressure to adopt country-by-country reporting. However, we remain concerned that the consequences of doing so have not been fully thought through, and that "risk assessment" purpose for which the country-by-country reporting information will be used involves a determination of whether the taxpayer's global profit allocations align with the way profits would have been aligned under a formulary apportionment system. In other words, the White Paper explains that the risk assessment process will be a determination of whether a taxpayer's income in any particular country is proportionate to its employees, assets, or sales in that particular country. Since this "risk assessment" process applies a different transfer pricing methodology (formulary apportionment) to evaluate the taxpayer's transfer pricing "risk" than the methodology a taxpayer must use to actually report its income on its tax return (the arm's length principle), we think it is important that the White Paper acknowledge explicitly that in many cases the outcome of the "risk assessment" will indicate that there is transfer pricing risk even where pricing is at arm's length. We are also concerned that the White Paper seems to allow tax administrations to choose from among several factors (employees, assets, or sales) to compare to the taxpayers allocation of income, and that when different countries choose different factors double taxation will be inevitable. [3] We therefore believe that it is imperative that all

[3] See, e.g., Andrus, Bennett, and Silberztein, "The Arm's-Length Principle and Developing Economies," 20 TM TPR 495 (2011) :

> The difficulty of these issues underlies the view of the OECD member countries that formulary apportionment is a less desirable system than transfer pricing based on the arm's-length principle. A developing country reaching a different conclusion would need to be prepared to address these questions, and to find ways to enforce its tax system without significant cooperation from countries that operate under the current arm's-length approach. This likely would lead to serious administrative problems and would certainly lead to double taxation or double non-taxation in

countries choosing to implement country-by-country reporting also agree to utilize mandatory binding arbitration to relieve the inevitable double taxation which will result.

It is also interesting to note that paragraph 72 suggests three different methods of consolidated reporting. As to management accounts, these are frequently not kept on an individual country basis and therefore the assumption that they could easily be used for this purpose without posing an undue burden on business is a significant assumption. Companies may keep management accounts on an entity basis, but if there is significant cross-border activity within an entity, which is not uncommon, than the burden of isolating country information may be significant. Also, management accounts may not correspond with concepts of taxable income. Management accounts may be prepared based on customer domicile, which would bear little or no relationship to the production of taxable income. Consolidating income statements also are generally done on a legal entity basis, which may or may not bear any relationship to a separate country approach; as with management accounts, isolating separate country information may be burdensome. Further, if different countries separately adopt each of these, the burden on companies would be increased significantly. If the idea is a general ballpark idea of where income and assets are within a MNE group, then the choice of how this is reported should be left to the MNE group. That is, since the purpose of this information is risk assessment, each group could provide this information based on management accounts, consolidated income statements and balance sheets, or tax returns, based on its decision rather than the OECD or countries providing a single method that each MNE group must adopt.

Further, there should be no penalties imposed if the information provided is considered insufficient. The OECD is attempting to create an entirely new system for information reporting in approximately a year. The likelihood that there will be significant issues that are discovered in the implementation of such a system is extremely high. If that is the case, then it is also likely that the OECD will need to make changes in response to the difficulties that are uncovered during implementation. Penalizing taxpayers under such circumstances is likely to result in taxpayers that have made good faith efforts to comply, being penalized, at least in part, because of defects in the system.

The burden to produce these numbers would be significantly greater if these numbers need to reconciled and audited; the White Paper makes a reference to “precision” not being necessary. If these numbers do not need to be audited or reconciled, that must be made explicit. Accordingly, it is recommended that the last sentence of paragraph 72 be amended to read that “precision is not necessary” and the first bullet point in paragraph 77 be strengthened and expanded to reflect that a documentation certification requirement for individual country data *is* excessive.

If this is not done, business believes that countries will require audit and reconciliation in the future. Requiring either audit or reconciliation of these numbers would significantly increase the burden associated with producing these numbers and would undermine the basic assumption that these numbers can be provided without creating an “undue burden”.

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many cases.

Another issue with respect to the masterfile is timing. Even unaudited and unreconciled numbers may not be available at the time that a tax return is due. It is not clear whether the taxpayer maintains the masterfile and simply provides the information on request. If so, then timing is less of an issue. Level of detail will also be relevant to timing. More general information, such as sales information, will be available before information on profitability. Paragraph 74 provides that "[i]nformation relevant to all countries could be assembled one time on an MNE wide basis and be supplied to any country requesting documentation." This implies that the taxpayer maintains the masterfile, but it is not clear if the country "requests" documentation by having rules in place requiring documents to be filed with the tax return or the tax administration actually "requests" this information when they are prepared to perform a risk assessment. If countries "request" this information with the tax returns, then timing is likely to be an issue.

It is not clear whether countries obtaining the masterfile information are required to adhere to any confidentiality standards. It is likely that the information in the masterfile will include information that would be considered trade secrets and therefore disclosure of the information could result in harm to the company. The OECD ought to require adherence to confidentiality standards before requiring this information to be disclosed to tax authorities. Further, because of confidentiality concerns, the notion of relevance, discussed below, ought to be incorporated into the requirement that information be provided to any particular country.

The global masterfile would not include any specific transfer pricing analysis, so to the extent that the requirements to produce specific transfer pricing reports remains the same, the documentation burden is increased, not reduced by the requirement to maintain the masterfile.

Because of these concerns, we suggest that the OECD ought to consider alternatives to country-by-country reporting. If, however, the masterfile approach is retained, then there needs to be more clarity around what is expected of and contained in the masterfile.

One alternative to the masterfile approach that should be given consideration is reporting similar to the uncertain tax position (UTP) reporting adopted by the IRS. This would seemingly provide more useful information with less of a burden on business.

Another possible approach would be a disclosure form for purposes of risk assessment (similar to the one proposed by the UN).[4] Disclosure forms could have significant advantages, although they also raise concerns. It may be impossible to design a single form that works for all industries. It may also be impossible to prevent countries from modifying the form to be more tailored to their particular concerns. While welcoming, the notion of a single simple form, business notes that under current rules the requirement to tailor transfer pricing documentation to fit different country formats is currently a costly problem for many companies. These issues would need to be addressed if a template is to be a workable solution. If a template is adopted, complete transfer pricing documentation would only be required, if necessary, after the risk assessment stage. There may be concerns that this approach would lead to less contemporaneous documentation of transactions. This concern might be addressed, at least

[4] Recent conversations with the OECD Secretariat indicate they are considering such a template.

in part, by looking at whether the taxpayer's transfer pricing policies are consistent across jurisdictions. Timing would be an issue here as well, since taxpayers' would need a reasonable time to prepare the required documentation.

Paragraph 73 states: " [T]hat the heart of transfer pricing documentation continue[s] to be the taxpayer's description of the transfer pricing methods and analysis it uses to demonstrate its compliance with the arm's length principle." This implies that the burden of preparing transfer pricing documentation for particular transactions will remain high. While sound transfer pricing documentation is critical, the OECD must explicitly address ways to reduce transfer pricing burden. In this regard, USCIB commends the work of the OECD to expand the use of transfer pricing safe harbors and encourages tax administrators to work actively towards adoption and implementation of bilateral and multilateral MOUs.

Paragraph 76 of the White Paper recommends that taxpayers should have the flexibility to provide masterfile information on either a company-wide or line of business basis. USCIB strongly supports this suggestion. It should also be made clear that tax administrations should not have access to information on a line of business if that business is not conducted in that country. The notion of a line of business reporting supports the concept of relevance. The reason for this distinction is that information from one line of business is not relevant to transfer pricing issues with respect to the second line of business.

Paragraph 77 makes some recommendations concerning mechanical issues on the process of preparing transfer pricing documentation. We strongly agree with the statement that country documentation standards should reflect materiality thresholds. We understand the reluctance of the OECD to set thresholds, however thresholds need to be meaningful. That is, they cannot be so low that all transactions between related entities in an MNE group will exceed the materiality thresholds.

Concerning the statement that certification of documentation by an outside auditor may be excessive, we believe this statement should be made stronger. This is excessive. We also agree that mandatory use of consulting firms ought not to be required.

Paragraph 80 describes the five categories of information. These are: information on MNE groups, a description of the business, information on intangibles, information on intercompany financial activities, and information on financial and tax positions. Requiring disclosure of all this information, even on a line of business basis, to any tax jurisdiction that requests it is excessive. There ought to be a base line requirement that the information be relevant to the computation of income tax within that jurisdiction before the information has to be provided. For example, if the debt levels and corresponding interest payments in the relevant jurisdiction are within acceptable ranges, it is not clear why the tax authorities in that jurisdiction ought to have access to financial information in the rest of the group that will have no bearing on the tax liability of the local entities.

Similarly, not all intangible information is relevant to each country. For example, trademarks, trade names and brands may vary in different countries even if the product line is similar. If, as tax authorities argue, local comparables are better than even regional comparables, is information on the value of a brand of shampoo sold in North America relevant to a brand of shampoo sold by a related entity in Asia or Africa? If the answer is no, why should it be provided? Internal comparables would be relevant and such information ought to be available, but if the transactions are not comparable, then providing information on a global line of business may result in a "haystack" of information that will only obscure relevant information.

It is the understanding of business that one of the concerns that has resulted in the proposal of the masterfile/local file documentation model is the difficulty of getting information from foreign related parties when there are transactions with local entities. Clearly, the information in the masterfile on the counterparty to a transaction would be relevant and therefore ought to be provided even if a relevance test were adopted. If, however, one company in the affiliated group engages in no transactions with another company in the affiliated group, and its transactions would not provide relevant comparables, would the information concerning these entities in any way be relevant to each other? If not, then taxpayers ought not to be required to provide it to local tax authorities.

Paragraph 81 provides that the local file supplements the masterfile and would help meet the objective that the taxpayer has complied with the arm's length principle in its material transfer pricing positions. It would include transfer pricing analysis related to material transactions between the local country affiliate and the associated enterprises. The materiality threshold is key to any burden reduction on this.

The third bullet point of paragraph 83 is particularly important. USCIB strongly supports uniform penalty provisions to ensure that the focus is properly on determining an appropriate amount of taxable income in each jurisdiction unweighted by consideration of other potential costs.

Table one lists the documents in the masterfile. As noted above, USCIB believes that there ought to be a requirement of relevance before this information is made available to any particular tax authority. In addition to that overall comment we have a number of questions and comments on the information in the masterfile. First, the chart illustrating the legal and ownership structure and geographical location of principal operating entities may create confusion. How are the principal operating entities defined? Is an R&D facility an operating facility? What is the effect of not identifying an entity as a principle operating entity? Second, the masterfile requires a written functional analysis showing the principal contributions to value creation by individual entities within the group. This would seem to overlap substantially with the local country functional analysis. If there is not intended to be overlap, how does this functional analysis differ from a standard FAR analysis? The focus on operating entities and "value creation" seems to elevate people functions over financing and risk.[5] The masterfile does not seem to take into risk into account at all. The only mention of risk in either Table 1 or Table 2 is the description of the FAR analysis of the local transactions. On financial and tax positions, the table asks for consolidated accounts for the prior (x) years **and** a copy of the company's consolidating income statement for the year. Paragraph 72 says "[i]t seems possible for businesses to provide without undue

[5] As USCIB's comments on the Revised Discussion Draft on Intangibles will make clear, we believe that the OECD is not properly reflecting the return to capital and risk in the intangibles draft. In the market place, funders of risky activities are entitled to a risk weighted return. If the documentation that is collected to justify transfer prices does not properly reflect funding and risk, then it will not be possible to determine the arm's length price properly.

burden individual country data based on **either** management accounts, consolidating income statements and balance sheets”[6] ….   Table 1 proposes to require both consolidated accounts and consolidating income statements. Also in paragraph 72 consolidating income statements are paired with balance sheets and on Table 1 the balance sheets are omitted. Does this also reflect a bias towards people function and against a return to assets?

On Table 2 the key to whether this reduces burden will be the definition of materiality. As mentioned before, if the materiality standard is too low, then this might even increase burden since companies as a matter of necessity have been applying informal materiality standards.

We appreciate the opportunity to comment and hope to work with the OECD to provide additional information that may be useful in making transfer pricing documentation both more useful and less burdensome.

Sincerely,

William J. Sample
Chair, Taxation Committee
United States Council for International Business

[6] Although this is hedged by the ambiguous “and/or” at the end of that sentence.