

*Chapter V*

**Documentation**

**A. Introduction**

5.1 This Chapter provides general guidance for tax administrations to take into account in developing rules and/or procedures on documentation to be obtained from taxpayers in connection with a transfer pricing inquiry. It also provides guidance to assist taxpayers in identifying documentation that would be most helpful in showing that their controlled transactions satisfy the arm's length principle and hence in resolving transfer pricing issues and facilitating tax examinations.

5.2 Documentation obligations may be affected by rules governing burden of proof in the relevant jurisdiction. In most jurisdictions, the tax administration bears the burden of proof. Thus, the taxpayer need not prove the correctness of its transfer pricing in such cases unless the tax administration makes a prima facie case showing that the pricing is inconsistent with the arm's length principle. The discussion of documentation in this Chapter is not intended to impose a greater burden on taxpayers than is required by domestic rules. However, it should be noted that even where the burden of proof is on the tax administration, the tax administration might still reasonably oblige the taxpayer to produce documentation about its transfer pricing, because without adequate information the tax administration would not be able to examine the case properly. In fact, where the taxpayer does not provide adequate documentation, there may be a shifting of burden of proof in some jurisdictions in the manner of a rebuttable presumption in favour of the adjustment proposed by the tax administration. Perhaps more importantly, both the tax administration and the taxpayer should endeavour to make a good faith showing that their determinations of transfer pricing are consistent with the arm's length principle regardless of where the burden of proof lies. In examination practices the behaviour of the tax administration should not be affected by the knowledge that the taxpayer bears the burden of proof where this is the case. The burden of proof should never be used by either tax administrations or taxpayers as a justification for making groundless or unverifiable assertions about transfer pricing.

**B. Guidance on documentation rules and procedures**

5.3 Each taxpayer should endeavour to determine transfer pricing for tax purposes in accordance with the arm's length principle, based upon information reasonably available at the time of the determination. Thus, a taxpayer ordinarily should give consideration to whether its transfer pricing is appropriate for tax purposes before the pricing is established. For example, it would be reasonable for a taxpayer to have made a determination regarding whether comparable data from uncontrolled transactions are available. The taxpayer also could be expected to examine, based on information reasonably available, whether the conditions used to establish transfer pricing in prior years have changed, if those conditions are to be used to determine transfer pricing for the current year.

5.4 The taxpayer's process of considering whether transfer pricing is appropriate for tax purposes should be determined in accordance with the same prudent business management principles that would govern the process of evaluating a business decision of a similar level of complexity and importance. It would be expected that the application of these principles will require the taxpayer to prepare or refer to written materials that could serve as documentation of the efforts undertaken to comply with the arm's length principle, including the information on which the transfer pricing was based, the factors taken into account, and the method selected. It would be reasonable for tax administrations to expect taxpayers when establishing their transfer pricing for a particular business activity to prepare or to obtain such materials regarding the nature of the activity and the transfer pricing, and to retain such material for production if necessary in the course of a tax examination. Such actions should assist taxpayers in filing correct tax returns. Note, however, that there should be no contemporaneous obligation at the time the pricing is determined or the tax return is filed to produce these types of documents or to prepare them for review by a tax administration. The documents that it would be appropriate to request with the tax return are described in paragraph 5.15.

5.5 Because the tax administration's ultimate interest would be satisfied if the necessary documents were submitted in a timely manner when requested by the tax administration in the course of an examination, the document storage process should be subject to the taxpayer's discretion. For instance, the taxpayer may choose to store relevant documents in the form of unprocessed

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originals or in a well-compiled book, and in whichever language it might prefer, prior to the time the documents must be provided to the tax administration. The taxpayer should, however, comply with reasonable requests for translation of documents that are made available to the tax administration.

5.6 In considering whether transfer pricing is appropriate for tax purposes, it may be necessary in applying principles of prudent business management for the taxpayer to prepare or refer to written materials that would not otherwise be prepared or referred to in the absence of tax considerations, including documents from foreign associated enterprises. When requesting submission of these types of documents, the tax administration should take great care to balance its need for the documents against the cost and administrative burden to the taxpayer of creating or obtaining them. For example, the taxpayer should not be expected to incur disproportionately high costs and burdens to obtain documents from foreign associated enterprises or to engage in an exhaustive search for comparable data from uncontrolled transactions if the taxpayer reasonably believes, having regard to the principles of this Report, either that no comparable data exists or that the cost of locating the comparable data would be disproportionately high relative to the amounts at issue. Tax administrations should also recognise that they can avail themselves of the exchange of information articles in bilateral double tax conventions to obtain such information, where it can be expected to be produced in a timely and efficient manner.

5.7 Thus, while some of the documents that might reasonably be used or relied upon in determining arm's length transfer pricing for tax purposes may be of the type that would not have been prepared or obtained other than for tax purposes, the taxpayer should be expected to have prepared or obtained such documents only if they are indispensable for a reasonable assessment of whether the transfer pricing satisfies the arm's length principle and can be obtained or prepared by the taxpayer without a disproportionately high cost being incurred. The taxpayer should not be expected to have prepared or obtained documents beyond the minimum needed to make a reasonable assessment of whether it has complied with the arm's length principle.

5.8 Consistent with the above guidance, taxpayers should not be obligated to retain documents that were prepared or referred to in connection

with transactions occurring in years for which adjustment is time-barred beyond a reasonable period of retention consistent with the body of general domestic law for similar types of documents. In addition, tax administrations ordinarily should not request documents relating to such years, even where the documentation has been retained. However, at times such documents may be relevant to a transfer pricing inquiry for a subsequent year that is not timebarred, for example where taxpayers are voluntarily keeping such records in relation to long-term contracts, or to determine whether comparability standards relating to the application of a transfer pricing method in that subsequent year are satisfied. Tax administrations should bear in mind the difficulties in locating documents for prior years and should restrict such requests to instances where they have good reason in connection with the transaction under examination for reviewing the documents in question.

5.9 Tax administrations also should limit requests for documents that became available only after the transaction in question occurred to those that are reasonably likely to contain relevant information as determined under principles governing the use of multiple year data in Chapter I or information about the facts that existed at the time the transfer pricing was determined. In considering whether documentation is adequate, a tax administration should have regard to the extent to which that information reasonably could have been available to the taxpayer at the time transfer pricing was established.

5.10 Tax administrations further should not require taxpayers to produce documents that are not in the actual possession or control of the taxpayer or otherwise reasonably available, e.g. information that cannot be legally obtained, or that is not actually available to the taxpayer because it is confidential to the taxpayer's competitor or because it is unpublished and cannot be obtained by normal enquiry or market data.

5.11 In many cases, information about foreign associated enterprises is essential to transfer pricing examinations. However, gathering such information may present a taxpayer with difficulties that it does not encounter in producing its own documents. When the taxpayer is a subsidiary of a foreign associated enterprise or is only a minority shareholder, information may be difficult to obtain because the taxpayer does not have control of the associated enterprise. In any case, accounting standards and legal documentation requirements (including time limits for preparation and

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submission) differ from country to country. The documents requested by the taxpayer may not be of the type that prudent business management principles would suggest the foreign associated enterprise would maintain, and substantial time and cost may be involved in translating and producing documents. These considerations should be taken into account in determining the taxpayer's enforceable documentation obligation.

5.12 It might not be necessary to extend the information required to all associated enterprises involved in the controlled transactions under review. For example, in establishing a transfer price for a distributor with limited functions performed, it might be adequate to obtain information about those functions without extending the information requested to other members of the MNE group.

5.13 Tax administrations should take care to ensure that there is no public disclosure of trade secrets, scientific secrets, or other confidential data. Tax administrations therefore should use discretion in requesting this type of information and should do so only if they can undertake that the information will remain confidential from outside parties, except to the extent disclosure is required in public court proceedings or judicial decisions. Every endeavour should be made to ensure that confidentiality is maintained to the extent possible in such proceedings and decisions.

5.14 Taxpayers should recognize that notwithstanding limitations on documentation requirements, a tax administration will have to make a determination of arm's length transfer pricing even if the information available is incomplete. As a result, the taxpayer must take into consideration that adequate record-keeping practices and the voluntary production of documents can improve the persuasiveness of its approach to transfer pricing. This will be true whether the case is relatively straightforward or complex, but the greater the complexity and unusualness of the case, the more significance will attach to documentation.

5.15 Tax administrations should limit the amount of information that is requested at the stage of filing the tax return. At that time, no particular transaction has been identified for transfer pricing review. It would be quite burdensome if detailed documentation were required at this stage on all crossborder transactions between associated enterprises, and on all enterprises

engaging in such transactions. Therefore, it would be unreasonable to require the taxpayer to submit documents with the tax return specifically demonstrating the appropriateness of all transfer price determinations. The result could be to impede international trade and foreign investment. Any documentation requirement at the tax return filing stage should be limited to requiring the taxpayer to provide information sufficient to allow the tax administration to determine approximately which taxpayers need further examination.

### **C. Useful information for determining transfer pricing**

5.16 The information relevant to an individual transfer pricing enquiry depends on the facts and circumstances of the case. For that reason it is not possible to define in any generalized way the precise extent and nature of information that would be reasonable for the tax administration to require and for the taxpayer to produce at the time of examination. However, there are certain features common to any transfer pricing enquiry that depend on information in respect of the taxpayer, the associated enterprises, the nature of the transaction, and the basis on which the transaction is priced. The following section outlines the information that could be relevant, depending on the individual circumstances. It is intended to demonstrate the kind of information that would facilitate the enquiry in the generality of cases, but it should be underscored that the information described below should not be viewed as a minimum compliance requirement. Similarly, it is not intended to set forth an exhaustive list of the information that a tax administration may be entitled to request.

5.17 An analysis under the arm's length principle generally requires information about the associated enterprises involved in the controlled transactions, the transactions at issue, the functions performed, information derived from independent enterprises engaged in similar transactions or businesses, and other factors discussed elsewhere in this Report, taking into account as well the guidance in paragraph 5.4. Some additional information about the controlled transaction in question could be relevant. This could include the nature and terms of the transaction, economic conditions and property involved in the transactions, how the product or service that is the subject of the controlled transaction in question flows among the associated enterprises, and changes in trading conditions or renegotiations of existing arrangements. It also could include a description of the circumstances of any

known transactions between the taxpayer and an unrelated party that are similar to the transaction with a foreign associated enterprise and any information that might bear upon whether independent enterprises dealing at arm's length under comparable circumstances would have entered into a similarly structured transaction. Other useful information may include a list of any known comparable companies having transactions similar to the controlled transactions.

5.18 In particular transfer pricing cases it may be useful to refer to information relating to each associated enterprise involved in the controlled transactions under review, such as:

- i)* an outline of the business;
- ii)* the structure of the organization;
- iii)* ownership linkages within the MNE group;
- iv)* the amount of sales and operating results from the last few years preceding the transaction;
- v)* the level of the taxpayer's transactions with foreign associated enterprises, for example the amount of sales of inventory assets, the rendering of services, the rent of tangible assets, the use and transfer of intangible property, and interest on loans;

5.19 Information on pricing, including business strategies and special circumstances at issue, may also be useful. This could include factors that influenced the setting of prices or the establishment of any pricing policies for the taxpayer and the whole MNE group. For example, these policies might be to add a mark up to manufacturing cost, to deduct related costs from sales prices to end users in the market where the foreign related parties are conducting a wholesale business, or to employ an integrated pricing or cost contribution policy on a whole group basis. Information on the factors that lead to the development of any such policies may well help an MNE to convince tax administrations that its transfer pricing policies are consistent with the transactional conditions in the open market. It could also be useful to have an explanation of the selection, application, and consistency with the

arm's length principle of the transfer pricing method used to establish the transfer pricing. It should be noted in this respect that the information most useful to establishing arm's length pricing may vary depending upon the method being used.

5.20 Special circumstances would include details concerning any set-off transactions that have an effect on determining the arm's length price. In such a case, documents are useful to help describe the relevant facts, the qualitative connection between the transactions, and the quantification of the set-off. Contemporaneous documentation helps minimise the use of hindsight. As discussed in Chapter I, a set-off transaction may occur, for example, where the seller supplies goods at a lower price, because the buyer provides services to the seller free of charge; where a higher royalty is established to compensate for an intentionally lower price of goods; and where a royalty-free cross-license agreement is concluded concerning the use of industrial property or technical know-how.

5.21 Other special circumstances could involve management strategy or the type of business. Examples are circumstances under which the taxpayer's business is conducted in order to enter a new market, to increase share in an existing market, to introduce new products into a market, or to fend off increasing competition.

5.22 General commercial and industry conditions affecting the taxpayer also may be relevant. Relevant information could include information explaining the current business environment and its forecasted changes; and how forecasted incidents influence the taxpayer's industry, market scale, competitive conditions, regulatory framework, technological progress, and foreign exchange market.

5.23 Information about functions performed (taking into account assets used and risks assumed) may be useful for the functional analysis that ordinarily would be undertaken to apply the arm's length principle. The functions include manufacturing, assemblage, management of purchase and materials, marketing, wholesale, stock control, warranty administration, advertising and marketing activities, carriage and warehousing activities, lending and payment terms, training, and personnel.

5.24 The possible risks assumed that are taken into account in the functional analysis may include risks of change in cost, price, or stock, risks relating to success or failure of research and development, financial risks including change in the foreign exchange and interest rates, risks of lending and payment terms, risks for manufacturing liability, business risk related to ownership of assets, or facilities.

5.25 Financial information may also be useful if there is a need to compare profit and loss between the associated enterprises with which the taxpayer has transactions subject to the transfer pricing rules. This information might include documents that explain the profit and loss to the extent necessary to evaluate the appropriateness of the transfer pricing policy within an MNE group. It also could include documents concerning expenses borne by foreign related parties, such as sales promotion expenses or advertising expenses.

5.26 Some relevant financial information might also be in the possession of the foreign associated enterprise. This information could include reports on manufacturing costs, costs of research and development, and/or general and administrative expenses.

5.27 Documents also may be helpful for showing the process of negotiations for determining or revising prices in controlled transactions. When taxpayers negotiate to establish or to revise a price with associated enterprises, documents may be helpful that forecast profit and administrative and selling expenses to be incurred by foreign subsidiaries such as personnel, depreciation, marketing, distribution, or transportation expenses, and that explain how transfer prices are determined; for example, by deducting gross margins for subsidiaries from the estimated sales prices to end-users.

#### **D. Summary of Recommendations on Documentation**

5.28 Taxpayers should make reasonable efforts at the time transfer pricing is established to determine whether the transfer pricing is appropriate for tax purposes in accordance with the arm's length principle. Tax administrations should have the right to obtain the documentation prepared or referred to in this process as a means of verifying compliance with the arm's length principle. However, the extensiveness of this process should be determined in accordance with the same prudent business management principles that would govern the

process of evaluating a business decision of a similar level of complexity and importance. Moreover, the need for the documents should be balanced by the costs and administrative burdens, particularly where this process suggests the creation of documents that would not otherwise be prepared or referred to in the absence of tax considerations. Documentation requirements should not impose on taxpayers costs and burdens disproportionate to the circumstances. Taxpayers should nonetheless recognize that adequate record-keeping practices and voluntary production of documents facilitate examinations and the resolution of transfer pricing issues that arise.

5.29 Tax administrations and taxpayers alike should commit themselves to a greater level of cooperation in addressing documentation issues, in order to avoid excessive documentation requirements while at the same time providing for adequate information to apply the arm's length principle reliably. Taxpayers should be forthcoming with relevant information in their possession, and tax administrations should recognize that they can avail themselves of exchange of information articles in certain cases so that less need be asked of the taxpayer in the context of an examination. The Committee on Fiscal Affairs intends to study the issue of documentation further to develop additional guidance that might be given to assist taxpayers and tax administrations in this area.