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Dear Mr. Andrus,

Response to White Paper on Transfer Pricing Documentation

Grant Thornton Canada, with input from Correspondent firms of the Grant Thornton organisation, welcomes the opportunity to comment on the white paper issued on 30 July 2013 regarding transfer pricing documentation.

We echo the Organization for Economic Cooperation and Development's (OECD) remarks regarding the current state of affairs of the transfer pricing documentation environment, and we agree the existing guidance on documentation is not sufficient to meet the transfer pricing requirements of today's economy. We appreciate the OECD's efforts in respect of this white paper and trust you find our comments helpful.

Establishing a universal approach to transfer pricing documentation is of course a significant challenge. As you noted, there exists tremendous variety in the transfer pricing laws and practices of tax authorities both in terms of tax return disclosure and documentation requirements. A sufficient level of documentation for one jurisdiction may be insufficient for another.

Section III of the white paper notes the purpose of transfer pricing documentation should be three-fold: to inform tax authority transfer pricing risk assessment, to assist taxpayers in assessing their compliance with the arm's length standard, and to provide information for tax audits. Such distinctions are useful in fostering the debate on documentation requirements and remind us all that there will be different requirements at different times from both the perspective of the taxpayer and tax authority. With this in mind, our comments address how universal documentation could or should meet each of these three objectives.

We have four core recommendations:

- Forego the Master File / Local File structure;
- Establish a 'minimum information requirements' listing;

- Allow for taxpayers to scale the level of documentation; and
- Separately address the objective of informing tax authority risk assessment

A detailed discussion of each is presented below.

Forego the Master File / Local File Structure

Grant Thornton works with companies that range from large multinationals to mid-size public companies (e.g., Russell 2000), complex privately held businesses, and high-growth start-ups. Despite often being international, small and medium-sized organizations generally have only limited expertise and/or resources to dedicate to transfer pricing compliance. Transaction sizes can be small, yet compliance requirements can be significant and the preparation of comprehensive transfer pricing documentation can be a relatively costly and onerous endeavour. Much reliance is therefore placed by these companies on OECD guidance, and the OECD's comments with respect to documentation are therefore particularly relevant.

When implemented correctly, the Master File / Local File approach (the "Master File structure") can be an efficient and effective strategy for addressing the compliance requirements for certain taxpayers. It is already an adopted practice among several of our larger clients and clients operating in a large number of jurisdictions. The structure can reduce the duplication of documentation and documentation effort, and can serve as a useful starting point for meeting local documentation requirements. As the OECD noted, it can also provide context to a tax examiner, which is crucial. The painting of a 'big picture' can dissuade examiners from adopting the local-jurisdiction-centric approach to transfer pricing; which, based on our experience, is pursued all too often.

Whether the approach is equally effective for small or medium-sized taxpayers, or taxpayers operating in only a small number of jurisdictions, is less apparent. In our experience, few taxpayers in the middle market have adopted a Master File structure to documentation. Further, implemented incorrectly, the Master File structure can complicate and/or confuse local documentation efforts, and can create inefficiencies and duplication, particularly in the case of less sophisticated taxpayers or taxpayers unable, due to cost or resource constraints, to make the investment in a large transfer pricing documentation project.

Problems with Master Files generally result from a lack of budget or resources, lack of communication and coordination, from language requirements, from timing issues, and from taxpayers' unwillingness to disclose information peripheral to the legislated transfer pricing requirements of each jurisdiction. We find these issues to be more prevalent in small-to-medium-sized taxpayers than in larger taxpayers.

The OECD must appreciate that taxpayers undertake risk management decisions in respect of transfer pricing documentation compliance, and a taxpayer's decision to document or not will be informed by transfer pricing penalty thresholds, by specific requirements of each jurisdiction, and by the cost of documentation. In the case of small taxpayers or taxpayers with small transactions, undertaking a Master File documentation structure may be unnecessary and may inappropriately divert funds from what should be the real goal: mindful pricing compliance. Documentation should not be done just for the sake of documentation.

To address our concerns in respect of small and medium-sized taxpayers, we ask the OECD to present alternatives to the Master File structure. Our recommendation would be to focus on the information elements themselves, as well as the principles of prudent documentation, rather than the structure. The commentary in Tables 1 and 2 could be presented without the differentiation between the Master File elements and Local File elements. A presentation of the Master File structure could still be included, but reserved for a separate or supplementary section, along with comments regarding its appropriateness or inappropriateness depending on the circumstances.

A focus on information elements and principles rather than documentation structure would provide taxpayers with clear direction, but would allow for flexibility. The level of diligence or sophistication of the documentation could then be more easily scaled based on taxpayer circumstance.

Establish a minimum information requirements listing

Due to the tremendous variety of taxpayers and taxpayer circumstances, it will be impossible for the OECD to recommend a single framework that will be optimal for everyone. Countries are establishing their own transfer pricing documentation rules at a dizzying pace, and compliance with each new regime places significant strain on taxpayer resources. Taxpayers are becoming desperate for standards to converge. Previous attempts to introduce documentation requirements by adding up every country's wish list (e.g. PATA) have proved unpopular and unwieldy, and as a result have not generated support from the business community. Support from compliant taxpayers is essential for the success of any proposal in our view.

In reviewing the information requirements of Tables 1 and 2, we note that at this stage the OECD has erred on the side of inclusion. The current listing is well beyond transfer pricing legislated/regulated requirements in most jurisdictions. The elements listed in Tables 1 and 2 may all be relevant to transfer pricing, but we suggest the OECD adopt a more flexible approach and a less prescriptive list to ease the burden on taxpayers.

We suggest the use of a minimum information requirements listing. Basic taxpayer and transaction information should of course be included, but more complex elements (such as, for example, capital structure/financing details or details with respect to intangibles) should be presented only when relevant. The objective of the listing should be to establish a minimum standard which could be relied upon in the case of jurisdictions with insufficient, or no, documentation requirements. The level of detail and information should be great enough to allow taxpayers to demonstrate a reasonable attempt at arm's length pricing, but should not be unnecessarily onerous.

We believe this could best be accomplished by focusing on a listing of minimum information requirements (effectively, a subset of the elements of Tables 1 and 2), as well as a set of principles. The principles should address the taxpayer's circumstances (i.e., number of jurisdictions, industry, transaction size, taxpayer size, and others), and allow the taxpayer to scale the level of documentation to those circumstances. For large taxpayers, complex transactions, or for taxpayers with large intercompany transactions relative to third-party transactions (i.e., higher-risk taxpayers), the principles should require the consideration of information additional to the minimum information requirements.

With that in mind, we do believe it would be helpful to the business community for the OECD to summarize or provide a listing of potentially relevant elements of documentation (a ‘comprehensive summary’). It should be clear the comprehensive summary would be a supplement to the minimum information requirements and would be for consideration purposes only. Taxpayers would be expected to assess the applicability of each of the elements of the comprehensive summary based on their circumstances, and would be expected to include certain elements in their documentation, as appropriate. This structure would allow small or medium taxpayers, or taxpayers with minimal intercompany transactions, to scale the level of documentation without sacrificing the provision of comprehensive guidance to large taxpayers or taxpayers with complex or highly material intercompany transactions.

The current listings in Tables 1 and 2 summarize many relevant elements for the purposes of the comprehensive summary, though we do have the following suggestions:

- Include disclosures related to economic dependence relationships (i.e., if a related company is captive or chiefly dependent on trade or support with/from another related party), such as contract manufacturing or sales agency relationships.
- With respect to the ‘Financial information’ section of Table 2, it may be helpful to include the segmented financial statements (for instance if the Transactional Net Margin Method was applied), as well as the segmentation procedure and assumptions, if applicable.
- Include disclosures related to customer concentration and target markets, as these factors may affect a company’s strategy as well as exposure to economic factors. For instance, a taxpayer with a small number of key clients may be less impacted by market factors than its competitors, but more impacted by client-related risks.
- Include a qualitative summary of the taxpayer’s performance and the performance of each business unit over the recent years, as well as reasons for the performance. If there are business reasons for particularly strong or weak performance, this information may be relevant to transfer pricing analysis.
- A description of the transfer pricing policies implemented by the taxpayer for the year.

Further, a number of the elements listed may require clarification or modification. Consider the following:

- We would welcome references to *summaries* and *overviews* of information rather than the detailed requirements listed. For example rather than "A written functional analysis showing the principal contributions to value creation by individual entities within the Group" the following wording "A summary of the principal functions of businesses operating within the Group".
- Rather than requesting internet links, which can be transient, request a summary of the relevant industry reports, company reports, stock analyst reports, or other reports relevant to characterizing the industry or business.
- If the Master File structure is retained, we do have two suggestions with respect to the organization of the information elements between Tables 1 and 2: A) Given the recent project, we appreciate the OECD’s focus on intangibles; however, the elements listed in Table 1 seem too far-reaching, at least for the purposes of the Master File (which should instead include a summary). Several of the bullets would be better suited in the Local File

section. It is important general information regarding intangible assets is presented in the Master File, but that information should be limited to documenting the value drivers of the business- not specific transactions, transaction history, which companies are entitled to returns, and details of intercompany agreements. B) Likewise, several of the elements in Table 1 regarding financial activities seem out of place, as related-party financing is simply another transaction subject to transfer pricing rules (and its particularities should therefore be documented in the Local File). The financial activities section of the Master File should focus on the financial activities of the taxpayer with third parties (i.e., banks and other lenders) and general capital structure policies.

In summary, we believe the inclusion of a ‘minimum information requirements’ listing, a discussion related to the principles of effective documentation, and a separate comprehensive summary of information elements would provide for the most effective guidance.

Allow taxpayers to prudently scale the level of documentation

We would like to expand on the idea of the ‘principles of effective documentation’ and focus on materiality. This consideration resonates particularly clearly with our clients. We appreciate the OECD’s acknowledgement that “not every intercompany transfer requires the same level of documentation” and that “not all transactions are sufficiently material to require full documentation” and we believe materiality should be considered both from the perspective of the size of the transaction (relative to the size of the taxpayer) as well as the size of the taxpayer (relative to other taxpayers).

A frequent challenge we face in performing transfer pricing services for all sizes of taxpayers relates to the conflict between costs and economic analysis reliability/documentation. A benchmarking study for a \$10 million transaction versus that of a \$100 million transaction may require the same number of hours, or even greater hours, depending on the complexity of the transaction and the information gathering required. We find that taxpayers will scale the level of analysis, diligence in information gathering, and documentation to both a) the size of their business and b) the materiality of transfer pricing issues in the context of their business. Is it not reasonable for a \$100 million taxpayer to undertake less diligence in their information gathering and analysis than a \$1 billion taxpayer? Likewise, is it not reasonable for a taxpayer whose intercompany transactions as a percentage of revenue are 2% to undertake less diligence in their information gathering and analysis than a taxpayer whose intercompany transactions as a percentage of revenue are 20%?

One-size-fits-all documentation guidance does not respect this reality, and we request more explicit acknowledgement by the OECD of the balance between documentation and cost. A statement or series of statements from the OECD regarding a ‘reasonable level of documentation taking into account the size and resources of the taxpayer’ would be helpful. This could build upon the commentary in the OECD’s Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations paragraph 5.28-5.29.

We appreciate that some territories, for example the UK, have exemptions in place for small and medium-sized enterprises. These are welcomed and we consider that such exemptions or safe harbours should be considered in conjunction with the global documentation standards project. We

do appreciate the OECD's efforts with respect to exploring the suitability of safe harbours, and we support the application of safe harbours to certain transactions.¹

Separately address the objective of informing risk assessment

We agree with the OECD's comments regarding the objectives of the Coordinated Documentation Approach (paragraph 79); however, as currently drafted, we do not believe the white paper thoroughly addresses the objective of informing risk assessment or audit selection (i.e., the first objective). Based on our experience, significant time and taxpayer resources are expended in the early stages of transfer pricing audits, or in the course of the audit selection procedures. Taxpayers are often requested to provide volumes of information which may or may not ultimately be used by the tax authority. This is based on tax authorities often applying an "ask for everything" approach, frequently before the decision to pursue a detailed examination is even made. For small or medium-sized taxpayers whose internal resources are already stretched, such requests can be tremendously burdensome. For this reason, establishing effective guidance for risk assessment and audit selection is important.

Our recommendation would be for the OECD to better distinguish between information relevant to the technical transfer pricing analysis versus information relevant to the risk assessment. The OECD posed the question "which elements of the documentation packages should be provided at the time the tax return is filed such that they would be available for risk assessment purposes, and which might be deferred until after the decision is made to conduct a more detailed audit."

We note the information requirements as per Tables 1 and 2 are generally comprehensive from a technical transfer pricing perspective. We also note a number of the elements listed seem to address the objective of assisting with tax authority risk assessment rather than the objective of informing transfer pricing analysis. For instance: information related to recent intangibles restructuring, intercompany financing structures, relative profit schedules and consolidation schedules, tax rulings, matters pending MAP procedures, and others are elements which would be important from a risk assessment standpoint but not necessarily from a technical transfer pricing analysis standpoint.

Further, consider that the tax authorities' transfer pricing documentation review process may be broken down into three stages:

- Review of information available to the tax authority at the risk assessment or audit selection stage;
- Review of information available to the tax authority for the purpose of analyzing the taxpayer's adherence to the arm's length standard (i.e., the transfer pricing documentation); and
- Review of supplementary information which may be gathered by the tax authority in the course of the examination to confirm the data and assumptions represented in the transfer pricing documentation.

¹ Please refer to our commentary dated September 14, 2012 in response to the June 6, 2012 OECD request for comment by the Secretariat of Working Party No 6, regarding safe harbors.

The first stage of review is comprised of a review of tax returns, transfer pricing disclosures filed with tax returns, and/or information in the public domain. Only a subset of jurisdictions require transfer pricing disclosures or forms be submitted with tax returns, and generally that information is cursory or high-level in nature. As an example, Canada requires taxpayers to submit transfer pricing information in cases of material intercompany transactions (in aggregate in excess of CAN\$1million), including information regarding transaction type, transaction amount, and pricing methods used.

In the case of Canada, transfer pricing documentation is not requested until after the risk assessment and audit selection procedure. It is requested when the formal transfer pricing audit is commenced. As the OECD notes, many jurisdictions operate in a similar way, and for this reason the inclusion of risk assessment elements in the transfer pricing documentation can be superfluous.

The OECD may be better served by separating the discussion regarding risk assessment from that regarding transfer pricing documentation, and preparing a separate section or series of sections in which comments relevant to risk assessment are presented. The objective of a risk assessment transfer pricing regime should be to provide information to tax authorities contemporaneously (i.e., along with tax returns) and to allow taxpayers to demonstrate mindful compliance. Risk ratings for taxpayers could then be established based on the initial information, and documentation requirements could be scaled to risk ratings.

The Canadian T-106 Information Return of Non-Arm's Length Transactions with Non-Residents regime is an example of a potential starting point for the OECD. The forms are filed along with the tax returns, and information presented includes the following elements:

- Transaction counterparty identification;
- Transaction type (product transfer, management fee, other service fee, financial transaction, intangible license, reimbursement, etc.);
- Transaction amounts;
- Transfer pricing method used;
- Intercompany payables/receivables balances;
- A question of whether transfer pricing documentation for the transactions was prepared; and
- Information relating to the preparation of transfer pricing documentation, existence of APAs, changes to transfer pricing methods used, and other elements.

Also, the Canada Revenue Agency has recently undertaken an initiative addressing tax risk management for large businesses. The new initiative focuses on taxpayer tax risk management resources, capabilities, processes and procedures rather than the details and technical merits of tax positions themselves. The information gathered is a significant departure from the technically-focused information gathered in the course of a full examination. Noteworthy elements include:

- Details regarding the corporation's internal tax function, including the number of staff, their roles, responsibilities, and professional experience.

- Details of any formal framework for identifying and assessing tax risks associated with normal on-going operations, of steps taken to address material risks and of the individuals who oversee tax risk management.
- Details regarding the extent and frequency of internal detailed tax reviews.
- Details regarding how tax policy has been “operationalized” (i.e., details regarding the manuals, procedures, procedures, and checks-and-balances utilized by operations staff day-to-day).
- A summary of tax matters that the board of directors and senior management get involved in, if any.
- A summary of how the taxpayer monitors the risk of non-compliance and what steps are taken when a potential issue is identified.
- A summary of systems and processes to ensure that data and information for tax purposes are accurate, reliable and maintained.
- Details of the use of external tax advisors for tax planning and compliance, including the scope of work and years for which assistance was provided.
- Details of any tax risk management committee and the extent to which the committee addressed transfer pricing.

We highlight these elements for the OECD’s consideration, but we are not suggesting the inclusion of any of these questions or elements into the guidelines for information disclosure for transfer pricing purposes. The Canada Revenue Agency gathers this information through in-person interviews with company management, and the nature of the information does not lend itself to written requests or prescribed requirements. It is interesting to note, however, the tax authority’s movement toward tax risk management review to inform audit selection.

We very much appreciate the OECD’s efforts with respect to the white paper and look forward to further material. We trust you found these comments helpful, and we welcome the posting of these comments on the OECD website if you deem appropriate.

For further information please contact:

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