

## INTERNATIONAL ALLIANCE FOR PRINCIPLED TAXATION

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### VIA E-MAIL

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### **Re: Comments on White Paper on Transfer Pricing Documentation**

Dear Mr. Andrus:

The International Alliance for Principled Taxation (IAPT or Alliance) is a group of about two dozen major multinational corporations based throughout the world, and representing business sectors as diverse as consumer products, media, mining, telecommunications, oilfield services, transportation, medical equipment, food products, luxury goods, computer technology, energy, pharmaceuticals, entertainment, software, beverages, automotive, IT systems, publishing, and electronics. The group's purpose is to promote the development and application of international tax rules and policies based on principles designed to prevent double taxation and to provide predictable treatment to businesses operating internationally.

The IAPT thanks the OECD for providing this opportunity to comment on the White Paper on Transfer Pricing Documentation.

The IAPT recognizes that tax administrations need adequate and sufficient taxpayer information to be able to effectively enforce the arm's length principle. We support an OECD initiative on transfer pricing documentation (TPD) which would "enhance transparency for tax administration, taking into consideration the compliance costs for business" as announced in the BEPS Action Plan. We support the OECD attempt to "move towards a simpler and more efficient compliance with transfer pricing documentation rules" by setting out a possible coordinated approach to transfer pricing documentation.

In doing so, we believe that the OECD should take into account a few essential guiding principles.

*In general*

- Some harmonization / standardization could be beneficial. We note however that templates tend to provide long lists of information and documents, many of which are not relevant to all taxpayers, industries or activities. The same information may not be relevant for a manufacturer, a distributor, a research and development entity, an intangible property company, a shared service centre, a financial entity, etc. Templates with country or industry variations could prove to be even more burdensome. It is therefore important that the template provided by the OECD remain realistic and not over-burdensome.
- Any transfer pricing documentation requirements enforced by countries on the basis of the OECD proposal should not be incremental to but replace what already exists in domestic legislation, in order to avoid that in a particular country two sets of transfer pricing documentation requirements would exist.
- We generally support the proposed two-tier structure consisting of a masterfile and a series of local files, to the extent that each of these two components is appropriately delineated. In practice, the masterfile and the local file would both be filed by local entities with their local tax authorities, so that it is important to clearly assign different objectives to these two components and to avoid unnecessary repetition.
- In our view, four types of documentation requirements should be distinguished:
  - Information filed with the tax return should be limited to information relevant for tax authorities to do risk assessment analysis and determine what taxpayers / transactions to audit. Such information should be simple for the company to extract from its accounting system (e.g. nature and volume of taxpayer's transactions with associated enterprises).
  - The masterfile should contain information relevant to transfer pricing analysis that is relevant to all the countries where the group (or a business unit or division of the group) operates.
  - The local files should contain information that is relevant to transfer pricing analysis in relation to a given country. Flexibility should be retained to produce local files covering all the entities in a particular country, or entity files covering one entity only, depending on what makes sense in a particular case. For instance, if an MNE group owns in a given country two entities which belong to different divisions or business lines and do not interact with each other, filing two separate entity files rather than one country file may be more appropriate.
  - Country-by-country reporting: this is a separate topic about which the IAPT plans to comment separately as part of its comments on the BEPS Action Plan. It should not be included in the TPD requirements as such, as it has potential implications well beyond transfer pricing.
- Information which is not relevant to risk assessment or transfer pricing analysis should not be required. TPD is not about administrations requesting a long list of "nice to have" documents.
- The OECD should be mindful of the costs that will be involved for businesses if it prescribes the production of information that does not exist and that necessitates significant investment (in time and IT systems). For instance, a breaking down of value chain analyses / supply

chains per product line per legal entity is an example of a huge undertaking which would create significant uncertainty (lacking a clear definition of what is required) and heavy compliance costs.

Requests for information such as a “Chart showing supply chain for material products and services”, “A written functional analysis showing the principal contributions to value creation by individual entities within the group”, “details as to which companies are entitled to returns from relevant intangibles” underestimate the complexity of producing such analyses in complex MNE groups with complex operations and a variety of products, services, and situations.

We believe that the adoption of *de minimis* rules in documentation requirements should be encouraged. The current proposal in the White Paper could lead to an explosion of documentation costs. Consistently with one of its announced objectives, the OECD should promote administrative and compliance simplification in the transfer pricing area.

- In addition to the contents of the documentation requirements, the timing for producing documentation is a critical issue. Not all information needs to be filed with the tax return. As noted at paragraph 79 of the White Paper, there is a risk assessment component to transfer pricing documentation which should be differentiated from the audit process itself. We support the notion that transfer pricing documentation should be twofold: information needed to perform risk assessment (such as the amount of intragroup transactions) could be filed with the tax return, while transfer pricing analyses needed to support the selection and application of the transfer pricing method (such as the functional analysis and benchmarks) should be produced at a later stage. In some countries, transfer pricing analyses are to be produced at the start of an audit upon request from the tax administration. We believe that this is a good practice.

Furthermore, not all information can realistically be filed with the tax return. For instance, in many countries comparables from transactions contemporaneous to the transaction of the taxpayer are not available at the time of the filing of the return.

Also, flexibility should be retained for MNE groups to produce portions of transfer pricing documentation covering several years in cases where the circumstances warrant it. This can be the case for instance for local entities carrying out small, low risk activities in a stable environment (see TPG 3.80-3.83).

- Finally, we believe that tax administrations should be committed to take into account the contents of the transfer pricing documentation produced by the taxpayer when such documentation has been established following the arm’s length principle and the OECD Transfer Pricing Guidelines. Transfer pricing documentation is costly and it can be a very frustrating process if tax auditors disregard it for no good reason. To be successful, any initiative to strengthen transfer pricing documentation requirements should be accompanied by improved certainty for compliant taxpayers. In particular, tax administrations should not substitute a transfer pricing method for the one selected by the taxpayer if the latter has been selected in accordance with the guidance in Chapter II of the Transfer Pricing Guidelines.<sup>1</sup> Otherwise, transfer pricing documentation becomes an unbalanced exercise which only provides information to tax authorities without providing any certainty to taxpayers.

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<sup>1</sup> This issue is linked to our comment on the proposed revision of paragraph 2.9 of the Transfer Pricing Guidelines, see separate comment letter on the Revised Discussion Draft on Transfer Pricing Aspects of Intangibles.

### *Masterfile*

- The information in the masterfile should be information which is susceptible of shedding light on the compliance with the arm's length principle and transfer pricing regulations by the entities in the jurisdictions concerned. While we understand that tax administrations are concerned that they lack a "big picture" view of a taxpayer's global value chain, we think that a balanced approach is needed. We find that the items of information to be included in the masterfile as currently listed in Table 1 of the White Paper exceed by far what can reasonably be expected to be relevant to effectively enforce the arm's length principle. They would create huge compliance costs for taxpayers without being necessarily helpful for tax administrations to apply transfer pricing regulations. It would be detrimental to the enforcement of the arm's length principle if vast amounts of information irrelevant to the application of the arm's length principle were systematically produced.
- We provide in Annex 1 a proposed list of contents for what we believe would be helpful in a masterfile.
- As acknowledged at paragraph 76 of the White Paper, there are issues regarding the usefulness of the masterfile in a business where more than one line of business is pursued. A coordinated documentation system would have sufficient flexibility to allow the taxpayer to supply masterfile information either on a company-wide basis or by line of business, depending on which would provide the most relevant transfer pricing information to tax authorities. Depending on the range of its activities, an MNE could have multiple masterfiles which might be broken down by business lines or particular activities or some other reasonable manner.
- In our view, the masterfile should be the common denominator for all countries where the group (or business unit or division of the group) operates. Information which is not relevant to all countries should go to the local files of the entities concerned.
- It follows that the information in the masterfile should be general, high level information. More granular information can be requested in the local files. For instance, the masterfile could contain an overview of a major business restructuring having affected the group globally, while the details of a business restructuring affecting a particular country would be in the local file. Similarly, the masterfile could contain an overview of the key functions, assets and risks of the group, with a detailed functional analysis and list of intangibles affecting a particular country being provided in the relevant local file. Similarly, the masterfile should contain an overview of the transfer pricing policy but the details of application and possible local variations should be in the local files.
- We find that many of the items currently listed in the proposed masterfile in Table 1 of the White Paper are either not relevant to transfer pricing analyses or too detailed to be part of a masterfile. It is also unclear to us what is meant by some of them, for instance "geographical location of key management personnel", and we do not understand how such information is expected to be used by tax authorities.
- An important concern with the proposed masterfile in Table 1 of the White Paper is that it seems to be based on the premise that MNE groups have or are able to produce and that tax administrations should base their transfer pricing analyses on profit split / global formulary apportionment types of approaches. The OECD should not encourage tax authorities to make transfer pricing assessments on the basis of factors which have more to do with the global

profitability of the group and the countries where profits are located, than with the actual economic activity performed in the country conducting the audit.

- The debate on country-by-country reporting is a complex one, especially when it comes to assigning clear objectives to it, determining the nature of information which should possibly be required to be disclosed on a country-by-country basis, the format of the reporting, and the bodies and countries to which it should be reported. This discussion needs to be carried out separately from the design of transfer pricing documentation; we appreciate the OECD's invitation to comment separately on the country-by-country reporting element of Action 13 of the BEPS Action Plan, and we intend to do so in a separate letter. We do not think that "A schedule showing for each country in which the MNE does business the total number of employees in the country" should be included in the masterfile. We find that the discussion at paragraph 72 of the White Paper is overly simplistic.

#### *Local file*

- We find that the list of information provided in Table 2 with respect to the local file is generally fine, with the exception of two items:
  - In the local entity section, "A description of the management structure of the local entity, to whom local management reports and the geographical location of senior executives". It is unclear to us what exactly is requested and how this affects the transfer pricing analysis; and
  - In the financial information section, "Information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements". It is also unclear to us what exactly is requested. Large companies consolidate many legal entities and many lines of business and, therefore, tracing through any particular local country details to the annual group financial statements would be very difficult. We think that such information is generally not available and should only be required if it adds significant value to the transfer pricing analysis.

We provide in Annex 2 a proposed list of contents for what we believe would be most helpful to be included in the local file.

#### *Economic analyses*

- We are disappointed with the statement at paragraph 77, 3rd bullet point that "A desire for simplifying compliance processes should not go as far as to undermine compliance with the requirement to use the most reliable available information." In practice, the costs of performing local database searches are significant and such local searches should only be required when there are reasons to believe that regional searches provide outcomes that materially deviate from local ones, for instance because of significant market differences.

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We recognise the critical importance of the work undertaken by the OECD in the area of transfer pricing documentation. We encourage the OECD to involve business representatives in this work in order to ensure that the practical recommendations which will be developed are helpful for tax

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administrations, are workable in practice for taxpayers, and do not set an unrealistic standard. The IAPT is willing to constructively contribute to this work by participating in any working group which may be set up with private sector representatives.

Sincerely yours on behalf of the Alliance,



Caroline Silberztein  
Baker & McKenzie SCP  
Counsel to the Alliance

cc: Ms. Michelle Levac, Chair, Working Party 6

## **Annex 1 - Proposed contents for a masterfile**

The following elements could be usefully included in the masterfile to the extent they are relevant to the transfer pricing analysis for all the countries concerned (see comments in the body of our letter for further explanations of what we believe should be the overarching principles for designing transfer pricing documentation including a masterfile):

- a) A general description of the multinational enterprise group's [or business unit's, or division's, depending on whether the masterfile is prepared for the group, a business unit or a division]:
  - Brief history,
  - Overview of the main lines of business / products / activities (depending on what is most relevant to the circumstances of the case),
  - Overview of the geographical footprint of the multinational enterprise group [or business unit, or division],
  - Key facts and figures (depending on what is most relevant to the circumstances of the case).
- b) A general description of the legal ownership structure, including a simplified chart showing the main relevant entities and their ownership links. [*Note to the OECD: MNE groups can have hundreds of legal entities, with changes to the legal chart happening throughout the year, so that the requirement in the masterfile should be limited to what is helpful for tax administrations to understand the global environment in which the taxpayer is operating.*]
- c) An overview of the industry and key economic factors which affected the activity during the period covered in the masterfile.
- d) An overview of the business and business strategy, including changes compared to the previous period; a general description of the important drivers of business profit, significant risks, list of the main markets for material products and services, key competitors.
- e) An overview of the global value chain, including:
  - a general description of the multinational enterprise group's [or business unit's, or division's] operational structure (including an identification of the main categories of entities or functions (for instance: manufacturers, distributors, logistic platforms, R&D centres, shared service centres, etc.).
  - key tangible and intangible assets used. [*Note to the OECD: more detailed information will be provided by each of the entities concerned in their local files.*]
  - a general description of the main controlled transactions, their nature (e.g. licenses, sale of semi-finished products, services, financial transactions) and direction of invoice flows (i.e. who is the seller, who is the buyer). [*Note to the OECD: more detailed information will be provided by each of the entities concerned in their local files.*]

- f) An overview of significant changes which took place during the period covered by the masterfile, including significant business restructurings which affected the multinational enterprise group [or business unit, or division] within the meaning of Chapter IX of the TPG that took place during the year. *[Note to the OECD: more detailed information will be provided by each of the entities concerned in their local files. The OECD suggests in the White Paper that the description of business restructurings should go back 5 years. We find that this would be an excessively burdensome requirement, especially for the first year of implementation of such a requirement, which would not add much value to the transfer pricing analysis of the current year.]*
- g) A general overview of the group's [or business unit's, or division's] financing policy.
- h) A general description of the multinational enterprise group's [or business unit's, or division's] inter-company transfer pricing policy.

## **Annex 2 - Proposed contents for a local file**

A local file should only be required from entities that have material transactions with associated enterprises. The following elements could be usefully included in the local file to the extent they are relevant to assess the conformity with the arm's length principle of the entity filing it (see comments in the body of our letter for further explanations of what we believe should be the overarching principles for designing transfer pricing documentation including a local file):

- a) Presentation of the entity filing the local file:
  - Address and tax identification number (if any) of the local entity filing the local file.
  - Identification and brief corporate history of the local entity, e.g. date of creation, mergers, etc.
  - Indication of the lines of business / products / activities in which the local entity is involved (depending on what is most relevant to the circumstances of the case).
  - Simplified legal chart showing the control relationship between the local entity and the foreign associated enterprises with which it carries out significant controlled transactions.
  - Copy of the entity's corporate income tax return for the period covered in the local file.
- b) Business environment:
  - Description of the key industry and economic factors which affected the business of the local entity during the period covered in the local file.
  - Description of the local entity's business and business strategy, including changes compared to the previous period; important drivers of business profit, significant risks, list of the main markets for material products and services, key competitors.
  - List of significant intangibles owned or used by the local entity.
- c) Identification of material controlled transactions in which the local entity is involved:
  - Their nature (e.g. sale of goods, provision of services, licence, financial transactions, etc.).
  - Identification of the foreign party to the transaction.
  - Aggregate amounts per category of transactions.
  - List of the material contracts entered into between the local entity and foreign associated enterprises.
- d) For significant transactions or categories of transactions with foreign associated enterprises:
  - A detailed comparability analysis, including a functional analysis of the controlled transaction, and changes compared to the prior period (see TPG

3.20-3.23 and 1.33-1.63). [*Note to the OECD: in accordance with the guidance in TPG 3.20-3.23, the functional analysis of the controlled transaction includes a functional analysis of all the parties involved, including the foreign associated enterprise(s).*]

- Where relevant: a description and justification of the evaluation of combined transactions or intentional set-offs (see TPG 3.9-3.17).
- An explanation of the transfer pricing method used by the group to *set* the transfer price.
- Where it is different: an explanation of the selection of the most appropriate transfer pricing method used to *test* the conformity of the transactions with the arm's length principle (see TPG 2.2-2.11).
- Where a transactional profit method is used: an explanation of the selection of the most appropriate financial indicator (see TPG 2.76 and 2.131).
- Where a one-sided method is used: an explanation of the selection of the tested party (see TPG 3.18-3.19).
- Financial information on the prices charged in the controlled transaction (in the case of a comparable uncontrolled price method) or on the relevant financial indicator at the level of the tested party (in the case of a cost plus, resale price or transactional net margin method) or parties (in the case of a profit split) , supporting the transfer pricing analysis.
- Description of the process for selecting internal and external comparables. Sources of information used, screening criteria (see TPG 3.24-3.46).
- Where relevant, an explanation of the comparability adjustments made, rationale for making them, and determination (see TPG 3.47-3.54).
- Summary schedules of relevant financial data for comparables used in the analysis.
- Where relevant, an explanation of the use of multiple year data (see TPG 3.75-3.79).
- Presentation of the arm's length range (see TPG 3.55-3.66).
- Conclusion on conformity (or not) with the arm's length principle. Corrective measures implemented if and where needed.

e) Business restructuring:

- Description of any material business restructuring within the meaning of Chapter IX of the TPG that has affected the local entity during the period covered in the local file.
- For any material business restructuring transaction having affected the local entity during the period covered in the local file:
  - Explanation of the business reasons for the business restructuring and identification of the restructuring transactions.

- Description of any transfer of valuable tangible or intangible assets, valuation thereof and assessment of compliance with the arm's length principle.
- Description of the termination or substantial renegotiation of existing arrangements and conditions thereof and assessment of compliance with the arm's length principle.

f) Others:

- A list of unilateral or bilateral APAs affecting the determination of the transfer prices of the local entity.
- A list of cost sharing agreements affecting the determination of the transfer prices of the local entity.