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To Pascal Saint-Amans, Director of the OECD Centre for Tax Policy and Administration

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From KPMG's Global Transfer Pricing Services

Ref

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Comments with respect to Draft Handbook on Transfer Pricing Risk Assessment

Overview

The Steering Committee of the OECD Global Forum on Transfer Pricing produced a draft Handbook on Transfer Pricing Risk Assessment (the "Draft Handbook"). The OECD released the Draft Handbook for consultation on April 30, 2013. Professionals in the Global Transfer Pricing Services practice of KPMG LLP (US) and certain member firms of KPMG International (hereinafter referred to as KPMG) welcome the opportunity to provide comments.

We have structured our comments in two sections. The first one provides KPMG's general major comments on the Draft Handbook. The second section provides comments tied to specific paragraphs of the Draft Handbook.

Section 1: General Comments

1) KPMG welcomes the emphasis put by the OECD on transfer pricing risk assessment. More particularly, we agree that there exists currently a significant waste of resources, both from a government and taxpayer perspective, with respect to either time-consuming transfer pricing audits which lead to no adjustments or with respect to transfer pricing adjustments which are not ultimately sustained, whether in the mutual agreement procedure (MAP) or elsewhere. As such, the use of a transfer pricing risk assessment system to better recognize transfer pricing risk and identify targets for audit would clearly be a very welcome tool.
2) There is a concern that the wording of the Draft Handbook seems, at times, closer to a guide on how to conduct an audit rather than focusing on the risk assessment part of the exercise. Indeed, it is the risk assessment portion that is crucial in ensuring a more efficient use of resources. Almost by definition, risk assessment can only be effective in lower compliance efforts on the part of both the tax administration and the tax authorities if it involves a lower

level of effort than a full audit. It may be useful to list things that would not be done in a risk assessment that would normally be done during the course of a complete audit.

3) KPMG is of the view that tax authorities should actively and contemporaneously monitor the use of their audit resources as it relates to transfer pricing to ensure that areas of potential waste are identified and corrected. Therefore, it would be useful for the Draft Handbook to include a section which discusses how such monitoring could be performed. For instance, tax authorities should be able to track:
    a. how many and what categories of cases are selected for transfer pricing audit and on what basis;
    b. the amounts of the proposed and final adjustments at the audit level;
    c. the number of hours spent by tax authority personnel and the outside costs, if any, in conducting the transfer pricing audit;
    d. the amounts of the final resolution of the case, whether under the MAP, the appeals or court systems.
4) KPMG strongly believes that tax authorities should share their transfer pricing risk assessment scoring system with taxpayers. This would make the process more transparent for taxpayers and would encourage them to adopt transfer pricing policies and practices that are less likely to be considered high risk. The OECD might also consider, as part of its work on the White Paper on Transfer Pricing Documentation, whether taxpayers falling in the low risk category could have lower compliance obligations (and costs). More generally, it is important that tax authorities engage in an open dialogue with taxpayers during the risk assessment process.

Section 2: Specific Comments

In this section, the comments appear in the same order as in the Draft Handbook and under the same headings.

1. INTRODUCTION TO TRANSFER PRICING RISK ASSESSMENT

¶3: The Draft Handbook mentions the waste of resources for both taxpayers and tax administrations when adjustments cannot ultimately be sustained in a MAP. Our first observation would be that the same waste, perhaps of a greater magnitude, occurs when adjustments are not ultimately sustained when cases proceed through court. Furthermore, we would recommend that tax authorities adopt a system to track transfer pricing audits and adjustments to be able to evaluate and explain whether resources are properly allocated and used. In our experience, there are jurisdictions where the administration's only or most important measurement of transfer pricing assessments is the aggregate amount of initial transfer pricing adjustments, without regard to whether such adjustments are ultimately sustained in MAP or in court.

¶8-10: It seems to us that the description of the "type" of taxpayers is overly simplistic: taxpayers are not either compliant as described in paragraph 8, or non-compliant as described in paragraph 9.

¶15: The second sentence mentions that "occasional losses are a genuine feature of business life." We believe that losses, particularly during recessions, can be more than occasional. In fact, for some taxpayers in some industries, there can be significant losses over long periods of time. Too often, transfer pricing analysis has a tendency to require that an entity in a given jurisdiction be always within the profitable portion of the range or to reject otherwise valid comparables because they have losses. Furthermore, adjustments to transfer part or all of a loss from one jurisdiction to another jurisdiction where there are even larger losses with respect to the same transaction have little chance of being sustained in the MAP process.

2. QUESTIONS TO BE ANSWERED IN A TRANSFER PRICING RISK ASSESSMENT PROCESS

We believe that, in most jurisdictions, there is a missing dialogue between tax administrations and taxpayers. Taxpayers should be able to explain to tax authorities their businesses and transfer pricing within their business environment. On the other hand, tax authorities should be able to explain to taxpayers what factors make them candidates for transfer pricing audits.

3. ASSESSING WHEN TRANSFER PRICING RISK EXISTS AND WHEN IT DOES NOT

Overall comment: it seems to us that, read *a contrario*, this section of the Draft Handbook is essentially saying that the only transactions which should not be cause for concern for tax authorities are those involving low-value routine transactions where the other jurisdiction involved is a high-tax jurisdiction. This hardly seems compatible with the statement at ¶3 and the need to avoid wasting resources.

It seems to us that, by focusing only on potential transfer pricing adjustments, there is a risk that this will only further exacerbate the strain that is already on MAP resources worldwide.

¶41: Why are "ongoing royalty payments" singled out only by the nature of the payment and not in relation to their size as other payments (through the use of the word "large")? We believe it is inappropriate to brand all royalty payments as being a cause for caution as compared to other types of payments. What heightens the risk for any transaction can be associated with the nature and structure of the payment combined with the amount of the payment: these must be considered together.

¶53: We welcome the reference to "industry standards" and we would encourage tax authorities to publish such accepted industry standards.

¶¶ 70-73: The OECD's treatment of service transactions within the Draft Handbook seems to cast a negative light on intra-group service transactions, a valid transaction type between members of a multinational group. Many taxpayers need to spend a disproportionate amount of their time and effort defending service charges due largely to suspicion by tax authorities toward these transactions, while this ultimately results in relatively minor adjustments or on adjustments not ultimately sustainable. Arguably, the mere inclusion of intra-group services within the Draft Handbook further casts aspersions on services transactions. We are also concerned about the comment made at paragraph 73: it seems an overly broad and subjective extrapolation and does not reflect our experience. Furthermore, it is arguable that less-than-fully documented transactions does not equate higher transfer pricing risk. The two concepts should be separated. We believe the Draft Handbook should simply treat intra-group services like any other transaction and, in performing risk assessment, consideration should be given to the degree of risk of the given transaction against the degree of possible sustainable adjustment. Perhaps the Draft Handbook should go even further and recognize that these transactions generally represent a very low risk (because the benchmarking is usually about identifying the right costs and then applying an appropriate mark-up) compared to other transactions.

¶74: The use of the concept of "economic substance" is not helpful as it is not a definable norm or yardstick by which to measure transactions or activities, etc. We believe that its inclusion in the Draft Handbook, as in other OECD documents relating to transfer pricing, risks being the basis for adjustments that will only contribute to further waste of taxpayers' and tax authorities' resources.

¶88: We welcome the inclusion of the existence of a significant unrelated minority shareholder as a factor which diminishes the risk level. We believe it is an important point that has not received recognition in the past: the minority shareholder(s) whose interest would be prejudiced by inappropriate transfer pricing would not normally stand still. Similarly, evidence of active external members of audit committees focusing on transfer pricing matters by, for instance, promoting the adoption of a tax/transfer pricing code of conduct/ethics, or actively informing themselves about the transfer pricing policies of a given company could also be seen as factors lowering the risk level.

4. SOURCES OF INFORMATION FOR CONDUCTING A TRANSFER PRICING RISK ASSESSMENT

¶¶104-106: We believe the OECD should also provide another warning about the use of information found on companies' websites or in other public fora: there is a natural bias to paint a rosier picture. Companies are unlikely to state that they are not as good as their competitors, that they expect their market share to shrink, or that they are really going out of business.

¶116: We welcome the suggestion of a meeting with taxpayers at the risk assessment stage. It can only benefit both parties if tax authorities better understand taxpayers' businesses and taxpayers understand what factors, if any, increase or decrease their transfer pricing risk level.

¶129: We believe that the Draft Handbook should go further in the last sentence of this paragraph and denounce the danger and injustice of using secret comparables.

5. RISK ASSESSMENT PROCESS – SELECTING CASES FOR TRANSFER PRICING AUDIT

¶138-139: We would suggest that the risk assessment report and the audit plan be shared with the concerned taxpayer.

6. BUILDING PRODUCTIVE RELATIONSHIPS WITH TAXPAYERS – THE ENHANCED ENGAGEMENT APPROACH

¶147: As stated before, we strongly believe that tax administrations should share their risk assessment reports with the affected taxpayers.