



Organization for Economic Cooperation and Development
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September 13, 2013

Dear Sirs,

Comments on the Organization for Economic Cooperation and Development (“OECD”) Draft Handbook on Transfer Pricing Risk Assessment

Thank you for the opportunity to provide comments on the revised discussion draft entitled Draft Handbook on Transfer Pricing Risk Assessment (the “Draft Handbook”). As a general matter, PwC supports the work being undertaken by the OECD to produce a practical handbook that provides guidance on transfer pricing risk assessment for global tax administrations to the extent that it encourages a focused, more harmonized approach to assessing transfer pricing risk internationally, thereby reducing uncertainty and maximizing efficiency for international taxpayers.

Our more detailed comments on each of the six sections of the Draft Handbook are provided below.

Section 1: Introduction to the Transfer Pricing Risk Assessment

1. The focus of section 1, and much of the Draft Handbook, is the finite resources of tax administrations and the need for administrations to allocate these resources effectively. It should be noted that international taxpayers face similar resource constraints and, in many cases, are subject to increasing global compliance obligations.
2. It is important that taxpayer resource constraints are also clearly recognized in section 1, and to emphasize that the risk assessment is ultimately designed to focus transfer pricing enquiries, such that it should work to reduce the audit burden for tax administrations and taxpayers alike.
3. The Draft Handbook would also benefit from the general recognition that taxpayers equally need to refer to risk assessment practices in order to determine their transfer pricing compliance approach. Some leniency from tax administrations, taking into consideration taxpayers’ cost of compliance, would be welcome in this respect.
4. Paragraph 3 of the Draft Handbook highlights that resources may not be efficiently used if devoted to cases where an adjustment can ultimately not be sustained in a Mutual Agreement Procedure (“MAP”). We highly welcome this remark, and believe that in this respect more effective communication at the level of the local tax administration and the Competent Authorities should be promoted in order to address the issue.



5. In addition, we recognize the way in which tax administrations currently interact with taxpayers differs between countries and the differences in level and form of interaction are likely to drive the risk assessment process. We recommend this is highlighted in the Draft Handbook for both taxpayers and tax administrations to consider.

Section 2: Questions to Be Answered In a Transfer Pricing Risk Assessment Process

Definition of Material Controlled Transactions

6. Defining material controlled transactions is an important part of any risk assessment and the guidance in section 2.1 would be made clearer by including a more prescribed materiality threshold. We recommend materiality be determined under a recognized accounting standard as could be applicable to the legal entity doing business in the country that would audit the transaction.
7. As currently drafted, the guidance in paragraph 23 encourages a closer than normal review of transactions undertaken by businesses that operate through a branch structure. This could unfairly disadvantage certain taxpayers and industries that are organized in this way for valid operational and/or regulatory reasons
8. Similarly, paragraph 24 encourages tax administrations to focus assessments on taxpayers that make large cross border intra-group payments. This approach is likely to encourage the disproportionate targeting of large international taxpayers.
9. While we welcome the guidance in paragraph 25 which promotes consideration of local factors when determining a materiality threshold, an unbalanced targeting of specific taxpayers or industries should be avoided in favor of a more principled approach to risk assessment.
10. These remarks are consistent with paragraph 15 of the Draft Handbook which states that risk identification and assessment cannot be reduced to a set of mechanical rules.

Base Erosion

11. Section 2.2 of the Draft Handbook is largely concerned with identifying related party payments that have the potential to shift income and erode the local tax base. While we agree that this is an important consideration, we acknowledge the work currently being undertaken by the OECD in this regard and recommend that such language is regulated within the Draft Handbook to ensure the guidance remains consistent with conclusions resulting from the Base Erosion and Profit Shifting ("BEPS") action plan.
12. The risk factors listed in section 2 to identify potential base erosion is broad and, at times, pejorative which may be unhelpful where it leads to a wide ranging risk assessment that increases the transfer pricing burden for taxpayers.



Risk Factors

13. Paragraph 27 of the Draft Handbook recommends tax administrations assess profitability of a local entity for consistency with similarly situated enterprises to assess transfer pricing risk. We note that complications often arise when comparing profitability of a taxpayer with that of local competitors. Complications include accounting for business strategies in the local market, international business structure, complexity of transactions or the availability of data. These complexities should be reflected more clearly in the Draft Handbook as well as the potential problems in relying on these findings to draw conclusions on transfer pricing risk.
14. Furthermore, given the problems in identifying sufficient local comparables, pan-regional searches are often the only viable alternative for taxpayers in the absence of publicly available data on local competitors (provided comparability attributes are sufficiently present). The EU Joint Transfer Pricing Forum (“JTPF”) has made a substantial contribution in this respect by promoting the acceptance of pan-European benchmarking searches. The current wording of the Draft Handbook and the reference to local competitors may be interpreted so as to contradict the acceptance of regional benchmarking studies and the work done by the EU JTPF and other interest groups.
15. References to low tax jurisdictions in the context of risk assessment, both in Section 2.2 and elsewhere in the Draft Handbook, may be potentially misleading given the recent move to reduce tax rates in several OECD member countries and the lack of a clear and commonly accepted definition of low tax jurisdictions. When assessing transfer pricing risk, placing significant weight on transactions with counterparties in low tax jurisdictions could lead to misdirection in the risk assessment process in future. In light of this, it may be prudent to remove this risk factor from the Draft Handbook.

Section 3: Assessing When Transfer Pricing Risk Exists and when it does not

Balanced Assessment

16. Paragraph 15 of the Draft Handbook states that balance is a key hallmark of a successful risk assessment. However, section 3 of the Draft Handbook lists a wide range of ‘high risk’ transactions and negative taxpayer behaviors to consider when assessing risk, with only a relatively small number of ‘low risk’ indicators embedded in paragraph 88.
17. While we welcome this high level guidance, the current emphasis on high risk indicators seems disproportionate and may lead to an imbalanced assessment.
18. We consider that greater balance could be achieved by emphasizing and expanding the list of low risk indicators. For example, referencing the low risk indicators towards the beginning of the Draft Handbook and/or recommending that low risk indicators are considered at the outset of any risk assessment should increase its influence in the risk assessment process and provide greater balance.
19. Furthermore, an additional low risk factor to be considered may be transfer pricing implementation and the ability of a taxpayer to demonstrate accurate implementation of its



transfer pricing policies. We believe a clear audit trail which demonstrates consistent application of a well documented transfer pricing policy should also help differentiate low risk taxpayers.

Large Number of Broad Risk Indicators

20. Section 3 suggests a significant number of transfer pricing issues for examination. While we appreciate this approach ensures a broad set of issues are considered and encourages tax administrations to pursue different lines of enquiry, we are concerned that it may promote an 'all encompassing' approach to risk assessment with multiple lines of enquiry that will further increase the compliance burden for taxpayers.
21. We highly recommend that the current guidance is tempered, urging caution, strategic thinking and the use of a customized approach for each assessment. Specifically, we recommend the Draft Handbook be updated to discourage generic, broad based assumptions at the outset of a risk assessment and clearly state that each taxpayer and risk indicator be considered in turn.

Comparison to Industry Standards or Potentially Comparable Companies

22. Paragraphs 53 and seq. of the Draft Handbook suggest consideration of 'industry norms' as indicators for transfer pricing risk and state that experience and knowledge from past audits may be helpful. This may be interpreted in a way as to promote the use of secret comparables in the hands of the tax administration as such financial ratios or audit experiences will not necessarily be available to taxpayers. We recommend this is clarified in the Draft Handbook.

Comparison to Related Parties or Group Results

23. Section 3.2.1.1.2 of the Draft Handbook recommends an analysis of the results of a local tested party with those of the related party in relation to a specific transaction, or in the context of the group as a whole. While theoretically this is a potentially useful tool for assessing transfer pricing risk, we would like to highlight the complexities in preparing this type of analysis and urge caution when assessing the results.
24. Specifically, it is often difficult to meaningfully assess the results of two related parties to a single transaction, particularly when both parties are part of a complex interconnected global operation and counterparties to a range of other transactions. For example, in the financial services industry where large numbers of individuals are frequently engaged in multiple international transactions, a transactional analysis may require a level of data granularity which is practically unobtainable.
25. Furthermore, viewing local operations in the context of broader operations and drawing conclusions should be done so with a broad understanding of the business and its global operations, the functions performed, assets utilized and risks assumed in all locations.
26. In order to avoid placing a disproportionate burden on taxpayers that may result in misleading conclusions, we are of the opinion that the proposed analysis contained within Section 3.2.1.1.2 is approached with caution and the guidance contained within the Draft Handbook updated accordingly.



Overseas Marketing or Procurement Companies

27. Paragraph 75 of the Draft Handbook states that marketing or procurement companies located outside the country where multi-national enterprises' customers are located, or where manufacturing takes place, may indicate that a taxpayer is following a strategy of accumulating income in intermediary companies in excess of what appears justifiable from an economic point of view. Whereas we recognize the need for substance to support the income allocation to central marketing or procurement entities, we are somewhat concerned that the paragraph generally takes a negative tone on such structures. In many industries, a centrally steered procurement or sales organization is necessary from an economic and operational standpoint. We would welcome if the paragraph could take a more balanced view in this respect by emphasizing that there may be valid operational reasons for adopting such a structure, which should be reviewed with the taxpayer on a case-by-case basis.

Indicators of Low Transfer Pricing Risk

28. The list of low risk indicators in paragraph 88 may benefit from mentioning the involvement of a taxpayer in advance pricing arrangements as well as the ability to demonstrate accurate implementation of transfer pricing policies. Other low risk indicators may include the absence of volatile results or consistent adherence to the arm's length range.

Section 4: Sources of Information for Conducting a Transfer Pricing Risk Assessment

Information Request

29. Section 4 provides an exhaustive list of information sources to be consulted by tax administrations during the risk assessment process. Consistent with our comments in relation to Section 3 of the Draft Handbook, we are concerned that such an exhaustive list of information could encourage a very broad approach to the risk assessment and preparation of detailed information requests that will significantly increase the compliance burden for taxpayers.
30. In many cases, collaborating with the taxpayer from the outset may provide tax administrations with the information required to complete the risk assessment in the most efficient way possible and a clearer recommendation to this effect would be helpful in section 4.

Transfer Pricing Simplification

31. Uniformity of approach to international transfer pricing risk assessment is welcomed, as is the proposed simplification of transfer pricing information requests and responses referenced in paragraph 94.

Contemporaneous Transfer Pricing Documentation

32. The wording in the fifth bullet point of paragraph 98 suggests that a taxpayer should, for each transfer pricing method, include a detailed explanation of why it was not selected. This appears contradictory to the guidance currently included in paragraph 2.8 of the OECD Transfer Pricing



Guidelines for Multinational Enterprises and Tax Administrations and current practice, as well as contrary to many countries' domestic laws and regulations.

Publicly Available Information

33. Section 4.5.1.1 indicates that useful information can be found on a company's website but notes, in paragraph 106, that this information will rarely describe activities of individual entities but rather focus on the company as a whole. We recommend that paragraph 106 is expanded to urge further caution when using a company's website as part of the risk assessment, as such websites may not accurately reflect the business for the period under consideration and be open to interpretation.

Section 5: Risk Assessment Process – Selecting Cases for Transfer Pricing Audit

Appropriate Tax Administration Organization for Conducting Risk Assessments

34. Section 5.1 of the Draft Handbook provides limited guidance on establishing an effective risk assessment approach, with passing references to the centralized, middle and decentralized models adopted by certain tax administrations.
35. We believe a clearly defined framework for risk assessment is critically important to ensure consistent, principled execution of the guidance contained in the Draft Handbook. Currently, the Draft Handbook refrains from making any judgments or clear recommendations when it comes to different practices used for risk assessment purposes. While it may be impractical and counterproductive to suggest a prescribed framework, section 5.1 could be expanded to include some clear recommendations on organization and the role and remit of the various stakeholders to any risk assessment, or a more detailed assessment of advantages and disadvantages of the different approaches.
36. Furthermore, this section could recognize that, in some jurisdictions, steps such as initial interactions with taxpayers are only possible in the case of a tax audit such that internal procedures may need to be revisited to ease a collaborative risk assessment process.

The Use of Specialists

37. Section 5.4 recognizes that successful risk assessment requires finely balanced judgment and the suggested use of experienced individuals and specialists to identify and assess risk is a welcome recommendation. However, guidance on identifying those people able to provide the necessary expertise and establishing their role and responsibility within the risk assessment, whether under the centralized, middle or decentralized model, would be a welcome addition.

The Risk Assessment Report

38. We believe it is extremely important that the Draft Handbook encourages tax administrations to share the results of the risk assessment with taxpayers to promote a more transparent and fair process.



Section 6: Building Productive Relationships with Taxpayers – The Enhanced Engagement Approach

Transparency and Collaboration

39. We highly recommend the promotion of a transparent and collaborative risk assessment process within the Draft Handbook and support the key theme of section 6. Ensuring tax administrations clearly define the risk assessment process at the outset and encouraging collaborative discussions with taxpayers should result in a better informed risk assessment, help distinguish the process from a transfer pricing enquiry and give greater certainty to taxpayers.
40. As currently drafted, paragraphs 147 and 148 state that businesses would welcome sharing risk assessment reports but stop short of recommending systematic sharing of reports in all circumstances. We strongly encourage a more definitive recommendation within the Draft Handbook for tax administrations to share risk assessment reports with taxpayers to encourage a principled, transparent process and ensure potential issues are addressed and resolved efficiently.

Once again, we would like to thank you for the opportunity to provide comments on this important transfer pricing development.

Yours faithfully,

A handwritten signature in black ink that reads "Adam M. Katz". The signature is fluid and cursive, with a large, stylized "K" at the end.

Adam M Katz
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A handwritten signature in black ink that reads "Isabel". The signature is cursive and elegant, with a long, sweeping underline.

Isabel Verlinden
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