

Transfer Pricing

February 2014

Comments on the OECD "Discussion Draft on Transfer Pricing Documentation and CbC Reporting"

Dear all,

WTS is pleased to provide you with comments regarding the OECD Draft on Transfer Pricing (TP) Documentation and country-by-country (CbC) Reporting. We appreciate the effort to provide guidance on this important topic on an international, cross-border basis, and assess the provided discussion draft as a first step in the right direction.

However, our overall impression is that the discussion draft seems to be very focused on providing tax authorities with more detailed information which leads to significantly higher administrative efforts on the side of taxpayers. Many countries already have well established regulations in place regarding the documentation of transfer prices which over the last years have well proved to be sufficient to satisfy the tax authorities by simultaneously not overloading the taxpayers. Hence, a further tightening and extension should be introduced with sound judgment, especially considering the added value of the additional information compared to the additional effort and expenses to be borne by the taxpayers. This should especially be considered when intending to introduce a mandatory CbC reporting for all internationally active groups. In addition, it would be very helpful to provide the taxpayer with a standardized documentation approach for all OECD countries as this could tremendously reduce compliance efforts whereas at the same time information consistency would be guaranteed for the taxpayer and all international tax authorities involved.

With our comments, we would like to emphasize several subjects which seem to be most important to us. Regarding these subjects we want to ask the OECD to rethink its opinions and amend the draft as may be appropriate. The following subjects are from our perspective the most important ones to be considered respectively revised:

- Extent of information requested

The information requested according to the proposed two-tiered TP documentation approach is substantially more extensive than the documentation requirements in place within most OECD member countries. To a certain extent the proposed additional information to be provided by the taxpayer may contradict legal obligations of the taxpayer, e.g. personnel rights of the employees. Accordingly, protection of data privacy also needs to be considered for TP documentation purposes.

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- Time frame
The proposed time frame represents a tremendous tightening of the time frame for the preparation of TP documentation according to the rules in place within most OECD member countries.
- Material thresholds
Material thresholds are highly welcome but it is absolutely necessary to introduce common materiality standards to avoid a deviating implementation within each OECD member country.
- CbC reporting
The expected added value of a CbC reporting does not justify the additional effort for the taxpayer and its introduction should be denied. Furthermore, WTS suggests that the OECD makes a strong statement in support of the opinion considering the comparable profit method respectively a formulary apportionment as being not acceptable.

In the following, we have clustered our comments according to the provided discussion draft and commented on the specified issues:

B. Objectives of transfer pricing documentation requirements

B.1. Transfer pricing risk assessment

From our perspective, the proposed two-tiered master and local file approach for TP documentation includes all relevant information necessary for the tax administration to perform a comprehensive TP audit. Hence, to avoid disproportional additional effort for the taxpayer no additional standard forms and questionnaires should be introduced to be additionally prepared besides the TP documentation.

Also a TP risk assessment or even audit on the basis of a CbC reporting does not seem possible in practice as the data to be included will not be representative nor comparable (further outlined in section C.1.).

However, we welcome the idea of sharing the results of the risk assessment of the tax authorities with the taxpayers. We follow the approach of a partner-like cooperation with the tax authorities including an open exchange of all relevant information. Additionally, informing the taxpayer on any risks identified from the tax authorities on an early stage gives the taxpayer the opportunity to respond to the risks accordingly and should reduce additional efforts on both sides also for the following years.

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B.2. Taxpayer's assessment of its compliance with the arm's length principle

We appreciate the emphasis on issues such as costs, time constraints and competing demands for the attention of the relevant personnel in section 12 and would like to ask to consider these issues in all discussed requirements. Thus, we would welcome the introduction of a material threshold for transactions to be documented in detail (further outlined in section D.3.).

B.3. Transfer pricing audit

We assume the currently applied rules, especially applied in double tax treaties, for the exchange of information to be sufficient to produce and share the relevant information needed for a local tax audit and also for a risk assessment. The intended scope of the master file and the CbC reporting could not be conform with current national regulations in place forcing the taxpayers to make a decision to either be compliant with national regulations or with the OECD documentation requirements.

Furthermore, non-disclosure is especially for MNE groups an important issue. It could not be in the interest of MNE groups that every single associated entity has to be provided with the same, confidential (tax) information as the parent company. This also seems to contradict the arm's length principle as e.g. no 3rd party would provide information to each of its customers regarding the transactions with all other customers. Especially from this perspective, a CbC reporting does not seem reasonable.

C. A two-tiered approach to transfer pricing documentation

C.1. Master file

First comment box - preparation of master file on a line of business basis:

First of all, as there is no common definition of "line of business" and to ensure that the master file covers all relevant information of a MNE group, the master file should generally be prepared on an entity wide basis. However, in the case that MNE groups are clearly separated in several business lines, we would recommend a two step approach in preparing the master file. The first part of the master file should contain all information on an overall group level relevant for all business lines. The second part of the master file should contain all relevant information of the respective business line and should be in combination with the first part the master file of the respective business line. Due to the lack of a clear definition of "line of business" we would recommend to pass the decision to apply this approach to the taxpayer and its defined internal business organization.

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Second comment box - CbC reporting:

According to the specially outlined issues we comment as follows:

- If against all concerns introduced, we would recommend to handle the CbC report completely separate. Especially due to time constraints collecting all the local data intended to be included in the CbC report and the corresponding efforts for the taxpayer, we would assume the preparation of a CbC report could hardly be performed within the same time frame as planned for the preparation of the master and local file (see section 28 of the discussion draft).
- To assess the question regarding the preference of a "bottom up" vs. a "top down" approach it is necessary to define allocation keys for the application of the "top down" approach respectively the allocation of the MNE group's consolidated income among countries. However, as we do not have knowledge of an allocation key which would ensure an appropriate allocation of consolidated income appropriately considering the specifics of every local entity, especially regarding IP, the "bottom up" approach should be preferred.
- As any facilitation for the taxpayer is welcome, we would prefer a separate individual country consolidations reporting instead of a preparation on entity by entity basis. However, this could create a conflict if a "line of business" approach is implemented.
- As for comparability purposes only an aggregate number for corporate income tax paid per country seems reasonable, only one aggregated number should be shown. However, to ensure comparability the taxes of each OECD member country being defined as "corporate income tax" should clearly be defined. Furthermore only taking into consideration the income tax will not lead to a full scope picture.
- Any reporting of aggregated numbers would be preferred, also for cross border payments, especially as these data is already included in detail in the local TP documentation and there seems to be no need to include it again in the CbC reporting. The numbers should be aggregated for each category of controlled transactions on a country by country basis.
- A clear classification of the nature of business activities carried out in a jurisdiction / by an entity only seems applicable for pure routine entities performing one business activity. Especially classifying entrepreneurial entities seems critical as they are usually performing several different business activities with significantly differing contributions to the respective value chains.

Altogether, we assume that a CbC reporting based on financial figures does not produce comparable and appropriate data for a TP risk assessment and audit and would give an incomplete and distorted view on a MNE group. As a conclusion it can be summarized that there is no appropriate rational and justification for the introduction of a CbC reporting. In section 21 of the discussion draft it is mentioned that the CbC data should neither be used as a substitute for a detailed TP analysis nor to constitute conclusive evidence re-

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garding the appropriateness of the applied transfer prices. Hence, we cannot see the added value of the additional information justifying the significant additional effort for the taxpayers. As already mentioned in section B.3., we again assume extensive legal and confidential issues in disclosing the proposed data on an group wide basis.

Also the respective local accounting standards are not reflected. Respectively no definition is provided how differences in local accounting standards should be considered.

Hence, we would strongly advise to not introduce such a CbC reporting as a regular part of the TP documentation as all data relevant for judging the adequacy of transfer prices are already included in the master and local file. Additionally, we would ask the OECD to make a strong statement that the arm's length principle to be applied on a transaction by transaction basis is the only acceptable approach for handling the taxation of intercompany transactions. The OECD should formulate a clear rejection regarding the so called formulary apportionment or any methodology based on the comparison of overall profits of legal entities. Especially the intention to introduce a CbC reporting combined with the discussion of a "top down" approach gives the impression that a change of the well established methodologies could be intended. A clear rejection within the guidelines would ensure the taxpayers that the draft does not lead to massive problems and an even more complicated regulatory environment in this regard.

Comments on Annex I:

Generally, we would recommend defining the content of the annex rather on a guideline basis than to have a mandatory list of which every component has to be reflected within the documentation of each taxpayer.

In addition, it should be considered if optionally general information regarding the description of (each category of) transactions, the corresponding application of the most appropriate TP method etc. could on a case by case basis also be included in the master file instead of each local file.

Furthermore, the following information seems problematic for a master file:

- "The title and country of the principal office of each of the 25 most highly compensated employees in the business line."
The disclosure of this information could trigger major issues within the multinational groups especially considering personnel rights of the affected employees.
- "MNE's annual consolidated financial statement for the fiscal year concerned."
Following the same argumentation as for rejecting the CbC reporting, this data is irrelevant for the local TP documentation of individual entities of the multinational groups as - under the arm's length principle - they have to be treated on a stand alone basis.

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- "Country-by-country reporting template according to Annex III."
See above for CbC reporting.

Additionally, as some of the used wordings are not clear and leave room for individual interpretation and definition, a definition especially for terms such as "important", "material" and "relevant" should be provided so that there will no major differences created through the implementation of the different tax authorities.

Finally, reporting of APAs, other rulings and MAP should only be required, if relevant for the documentation of the appropriateness of the applied transfer prices and hence be optional.

C.2. Local file

Comments on Annex III:

Generally, the same comments as for Annex I are valid for Annex III.

Furthermore, the following information seems problematic for a local file:

- "... and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices."
There could be differing views regarding this issue.
- "Information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements."
Following the same argumentation as for rejecting the CbC reporting, this data is irrelevant for local TP documentation. Furthermore, already the used wording "may be tied" shows that it is unclear if respectively how taxpayers can provide such data without having to face unpredictable and disproportionate additional compliance efforts.

Additionally, a definition for the term "category of controlled transactions" should be provided respectively the possibility of summarizing transactions should be outlined.

D. Compliance issues

D.2. Time frame

D.5. Frequency of documentation updates

From our perspective it is not reasonable to have a master and local file being prepared no later than the due date for the filling of the tax return. If the arm's length principle is already considered on a contemporaneous basis, it is sufficient to prepare the master and local file the latest on request by a tax audit.

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Especially as the local file is based on the master file, the taxpayer should be given sufficient time to first collect the relevant data on a centralized basis before rolling out the master file to the respective local entities for preparation of the local file. It also has to be considered that the filing of a tax return generally does need significantly less and almost only local information. Furthermore, the date that a "tax return is filled" is absolutely unclear and differing between the OECD member countries. Also it is possible in some countries to file the tax return earlier than legally required, e.g. if a tax refund is expected, which would almost be unconvertible if the TP documentation is mandatory for the filling of the tax return.

Commenting on section D.5. of the discussion draft, it should also be sufficient to prepare the TP documentation for multiple years, e.g. according to the number of years of the next tax audit. However, in this case it would also be necessary to give a guideline regarding the number of years a normal tax audit should cover to ensure comparable application within all OECD countries.

Hence, we would recommend to request a multiple year TP documentation, in general for the time covered by one tax audit, that would be required by the taxpayers no earlier than one year following the last day of the fiscal years of the audited entity and giving the taxpayer sufficient time to prepare the relevant data after the request, e.g. at least 2 months. The corresponding searches in databases should cover the same multiple year period.

D.3. Materiality

As described in section B.2. above, the introduction of a materiality threshold would be highly appreciated.

In some countries, such as Germany, material thresholds are already in place regarding the obligation for SMEs to prepare a written TP documentation, if the total transaction volumes are below a certain material threshold. Hence, we would recommend that also single transactions between two related parties below a material threshold should e.g. only be listed instead of being documented in detail.

We would recommend to introduce such materiality standards differentiating between transactions regarding the delivery of goods and other transactions (such as services, interests etc.). We would prefer setting such materiality standards as total numbers, however to reflect the materiality of a transaction in comparison to the total business of an entity relative numbers would also be an option.

Furthermore, materiality standards for SMEs as mentioned in section 30 should be defined as well as the corresponding lower documentation requirements.

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D.6. Language

We highly appreciate the approach to prepare and submit the master file in English. Furthermore, we would also recommend giving taxpayers the possibility to also prepare the local file in English as in most MNEs information and (cross-border) communication also is in English. A translation in local language should only be prepared upon request within a tax audit and be limited to the unclear respectively most important sections of the local file.

D.9. Other issues

According to section 42, the most reliable information will usually require the use of local comparables over the use of regional comparables. However, to our experience the comparability of some markets does not differ between the regional and the local level. This argumentation is supported by a report of the EU Joint Transfer Pricing Forum defining Europe as one comparable market.¹ Furthermore, comparables which are from different countries but fulfill the comparability criteria in a better way should be preferred against those being in the same country but fulfilling the comparability criteria less. Thus, we would recommend not preferring a local comparability analysis over a regional comparability analysis in general but giving the responsibility to determine the most appropriate analysis to the taxpayer on a case by case basis.

E. Implementation

As every local entity is a separate taxpayer, the direct local filing of information by each local entity seems the most appropriate approach.

Overall we would like to ask the OECD to revise the discussion draft and keep the focus on more standardization and facilitation resulting in lower compliance costs and efforts for the taxpayers regarding TP documentation. The current discussion draft with its additional issues will make the documentation process more complicated and extensive than it is already.

¹ Report on the Activities of the EU Joint Transfer Pricing Forum in the Field of Documentation Requirements"; EU Joint Transfer Pricing Forum, Brussels May 27, 2005 (DOC: JTPF/020/REV4/2004/EN); Furthermore: Is Europe one market? A Transfer Pricing Economic Analysis of Pan European Sets"; by Dr. H. K. Kroppen, EU Joint Transfer Pricing Forum, Brussels February 24, 2004.

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